GIVING CONSUMERS CREDIT: HOW IS THE CREDIT CARD INDUSTRY TREATING ITS CUSTOMERS?

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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GIVING CONSUMERS CREDIT: HOW IS THE CREDIT CARD INDUSTRY TREATING ITS CUSTOMERS?

THURSDAY, NOVEMBER 1, 2001

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The subcommittee met, pursuant to call, at 10:00 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus, [chairman of the subcommittee], presiding.

Present: Chairman Bachus; Representatives Roukema, Oxley, Bereuter, Castle, Cantor, Grucci, Hart, Tiberi, Waters, C. Maloney of New York, Ackerman, Sherman, Moore, J. Maloney of Connecticut, Hooley, Carson, Ford, Hinojosa, K. Lucas of Kentucky, Crowley and LaFalce.

Also present: Rep. Chris Smith.

Chairman BACHUS. We'll call together the Financial Institutions Subcommittee of the Financial Services Committee. I hope you all survived Halloween. The subcommittee meets today to examine credit card industry practices, particularly as they relate to the treatment of cardholders.

The ready availability of credit in our country has had many beneficial effects, fueling economic growth and making the American Dream more accessible to many low and moderate income consumers. But the American Dream has become a nightmare scenario for many citizens who find themselves and their families overextended and saddled with thousands of dollars in ever-escalating debt. Particularly as our country struggles to come out of its current economic downturn, it is entirely appropriate that the subcommittee take a hard look at credit card industry practices to ensure that the financial stress that many consumers find themselves under is not needlessly exacerbated.

Factual evidence paints a powerful story in tracing the growing reliance of American households on credit cards. Last year alone, credit card companies extended $3 trillion in credit to American consumers, nearly double the levels of just 5 years ago. The total amount of consumer credit card debt now exceeds $500 billion. Americans are bombarded on almost a daily basis by credit card solicitations which come through the mail, over the internet, and in those dreaded phone calls at dinner hour, an aggravation that is mentioned often by my constituents.

Like most parents of college-age children, I have a particular interest, financial and otherwise, in the aggressive tactics used to market credit cards on college campuses. The statistics in this area are also telling. Almost one-quarter of college students actually get their first credit card before they even leave high school. Not surprisingly, the past decade has witnessed a 50 percent increase in the proportion of people under the age of 25 filing for bankruptcy.

I have always subscribed to the view that the Government should not be in the business of saving its citizens from the consequences of their own bad choices, including the choice of a college student to rack up large amounts of credit card debt. But there's also something to be said for industry self-restraint when it comes to marketing credit cards to teenagers and other members of society who may not fully understand the hole they're digging for themselves through the irresponsible use of credit.

Among the issues that our witnesses have been asked to address at today's hearing are the following:

How the credit card industry sets interest rates and how these rates compare to the cost of other forms of consumer credit.

How credit card companies disclose information to their customers, including changes in terms, teaser rates and fees.

The process and practices of the industry, including the posting of payments and the handling of customer complaints.

Four, industry compliance with Federal consumer protection laws and the privacy requirements imposed by Gramm-Leach-Bliley.

Fifth, the response of the credit card industry to the events of September 11th, including what efforts have been made to assist law enforcement in disrupting terrorist financing.

On this last point, I want to take the opportunity to commend those credit card issuers that have taken steps to provide relief in the form of liberalized interest and fee policies and other accommodations to those customers in New York and Washington directly affected by the terrorist attacks on September 11th.

I hope that the industry will exhibit a similar spirit of forbearance when dealing with customers who have had their mail service interrupted by the recent anthrax cases along the East Coast. In that regard, Chris Smith, Representative Smith, who's had two mail facilities in New Jersey closed, has actually prepared some legislation.

I hope that the industry will talk with Representative Smith and see if some accommodations can be made for those customers.

Let me close by thanking all of our witnesses for agreeing to testify this morning on fairly short notice. We appreciate your attendance. I now recognize Mr. LaFalce for any opening statement that he would like to make.

[The prepared statement of Hon. Spencer Bachus can be found on page 64 in the appendix.]

Mr. LAFALCE. Thank you very much, Mr. Chairman. As the Ranking Member of the Full Committee, I don't attend too many subcommittee hearings, but this I consider to be of tremendous import. It's a hearing that I've been seeking for about 7 years, and I was absolutely delighted when the Chairman of the Full Committee and subcommittee about a week or so ago agreed to have the hearing.

I believe that the credit card industry practices and the growing problems of consumer credit card debt are extremely important issues. For years now I have received more letters from my constituents complaining about credit cards than any other consumer financial issue.

What's interesting is how these letters have evolved over the years in response to changing practices of the industry. In the mid-1990s, most of these letters complained of the growing numbers of misleading credit card solicitations. As far as I'm concerned, too many in the industry are guilty of that.

Of arbitrary interest rate increases. Again, as far as I'm concerned, too many in the industry have been guilty of that.

Of the hidden fees and charges. Absolutely. I mean, what some institutions are doing is absolutely atrocious.

New penalties for making monthly payments late, and I think the bills are being sent out later, the grace period has been shortened, the posting is delayed. And then, of course, the penalty, the fee, somehow they must have come to a consensus about $29 regardless of the fact that the minimum payment due is $10.

And then, of course, the unbelievable proliferation in solicitations to college students and minors, where I believe—you can correct me if I'm wrong—that the average college student has about four credit cards today.

Related to that, I'm extremely concerned about college student use of credit cards for the purpose of internet gambling on the laptops in their dormitory rooms, and the credit cards that they have arriving through their mail at the rate of one or two a week.

A word on internet gambling. We just passed a bill out yesterday. Independently of that bill, and I don't know what's going to happen with it, but I will be writing a letter. I'm in the process of drafting it now. I just advise you of this—to every referee in bankruptcy telling them that based upon judicial interpretations of existing law, most especially the Wire Act, you are engaged in an illegal activity. And therefore, anybody who has a debt in a bankruptcy court cannot have that debt enforced against them by anybody who aided and abetted them, that is, a financial institution or a MasterCard, Visa or what have you, and therefore, those debts should be automatically discharged.

Second, I'll be writing to every financial regulator telling them with respect to every financially regulated institution, that if they permit internet gambling and the use of credit cards, ipso facto, they are involved in an unsafe and unsound banking practice, and therefore, they should stop immediately. Just put you on notice.

In response to the problems that were brought to my attention daily in the mid-1980s, in 1998 I introduced a bill to address the most unjustifiable of these practices by credit card companies. I reintroduced it in 1999, and again earlier this year as H.R. 1052. And while the Judiciary Committee has acted on two occasions to incorporate at least five of my credit card proposals—there are roughly a dozen—within the bankruptcy bill, my particular bill has never been considered by this subcommittee.

But the problems have evolved. Now there's a pattern of abuses and conduct by credit card companies that in my view approach outright fraud. The same practices have figured prominently in a number of major legal settlements over the past 2 years, including, and I'll just tick off a few:

1. A $3.2 million settlement by Direct Merchants Credit Card Bank to settle OCC charges that the bank regularly engaged in bait-and-switch schemes in which consumers are marketed preapproved credit card offers with attractive terms, but receive far less favorable credit card accounts with undisclosed processing fees.

2. A $45 million agreement by Citibank to settle complaints that the bank did not credit consumer payments upon receipt and improperly assessed late fees and interest charges.

3. A $300 million agreement by Providian National Bank to settle OCC charges that the bank routinely billed accounts for products and services consumers had not approved, enticed consumers to transfer balances with inflated claims of cost savings, and imposed annual fees on accounts that advertised no annual membership fees.

4. A $40 million agreement to settle customer complaints that FirstUSA solicited credit card accounts with initial rates of 6.5 percent that were quickly changed to a floating annual rate above 22 percent and misrepresented payment due dates in billing statements.

I could go on and on and on. Let me also say, a number of these actors have cleaned their act up, to their credit. But a lot of damage was done.

In all of these and other major settlements, the financial institutions involved all stated publicly that "we've broken no law." And they all say they settled only to cut legal costs or minimize adverse customer relations. So, "we didn't do anything. We'll pay you $300 million, but we didn't do anything wrong." Well, you know, technically they may have been correct, and that's the problem. There currently is no clear-cut Federal law that adequately addresses these consumer abuses.

The Truth in Lending Act was enacted over 30 years ago when credit cards were first appearing in the marketplace. And TILA is concerned primarily with disclosure of credit interest rates and deals only marginally with the administration of credit card accounts. The FTC's standards for unfair and deceptive business practices under the FTC Act do not apply by statute to regulated financial institutions. And the Federal Reserve Board has yet to exercise its long-standing discretionary authority to define unfair acts or practices in connection with credit cards or other credit transactions.

Mr. Chairman, this is one area where clearly there ought to be a law.

Chairman BACHUS. I thank the Chairman.

Mr. LAFALCE. I thank you for that designation.

Chairman BACHUS. The Ranking Member.

[Laughter.]

Chairman BACHUS. At this time we're going to hear from Mr. Sherman. We're going to have one more opening statement on each side. I did it as people requested. But do you have an opening statement? I'll recognize the gentleman from New York. Or how about Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman. I'd like to comment on the comments of our Chairman. I agree, shame on a credit card company that is remitting money knowingly to those engaged in the business of illegal gambling. The problem that I see is how will a credit card company know that a particular entity based in the Bahamas—you could call yourself the Bahamanian Sweater Company and claim to your bank that you're engaged in selling sweaters or bathing suits, or you could call yourself the Bahamanian Gambling Site. And that's why I think it's important that there be at least an official, and if we can't get it done officially, at least a semi-official list of those who are making charges on credit cards, those who are vendors in the credit card transaction that are not selling sweaters but rather chances of winning in gambling.

The other point I want to make relates to some legislation that I'm going to introduce soon that I hope many of those present here will choose to co-sponsor, and that deals with what's happening now. And that is, people are mailing in or trying to mail in their payments, and it's not arriving at the credit card office on time. Now we're all familiar with late charges and finance fees, and they can be horrendous. And if we're really late in sending in the money, I guess maybe there's a fairness to it. But when people here in Washington, DC. try to mail their payment and it's delayed for 4 or 6 days or the mail is sent to Ohio for irradiation on its way to credit card payments, that should not be the consumer's fault and certainly shouldn't lead to finance charges.

I'm told that many banks are waiving those charges on request. It should not be the consumer that has to make that request, and I know that there are some credit card companies that aren't waving these fees at all. They're saying we got your payment late, we're assessing the fee. What my bill would do is apply to those payments of less than $10,000, because if you owe somebody $10,000 on a particular date, maybe you ought to wire them the money, but rather regular consumer payments on credit cards, regular consumer payments of mortgages, and say that where the Postmaster General determines that there is a delay in the mail due to an extraordinary occurrence, whether it be an act of terrorism or whether it be a hurricane or whatever, that consumers are given an additional grace period.

And I think that a lot of us if we talk to our constituents are going to find people who are either getting hit with finance charges that they think are unfair or are calling in in order to get the finance charges reversed.

So I hope to have some support for a bill to provide these additional grace periods when our mail system is interrupted by either acts of God or acts of man, and I yield back.

Chairman BACHUS. Thank you.

At this time we yield to the Chairman of the Full Committee for an opening statement.

Mr. OXLEY. Thank you, Mr. Chairman, and I'd like to commend you for holding this important hearing today. Americans hold more credit cards and carry more credit debt than ever before. With the current sluggish economy, problems with the mail, this Subcommittee needs to examine the credit card industry to ensure that credit card holders are treated fairly.

The industry has had problems in the past. The posting of payments, teaser rates and fees. We must ensure that these practices do not resurface. Of the three types of consumer credit available in the financial services industry involving bank card credit accounts for only 10.4 percent of outstanding consumer credit, an amount of slightly less than $858 billion. Installment loans, car loans, for example, account for 13.9 percent, or $782 billion, and home mortgages account for $4.3 trillion, about 75.7 percent of all outstanding consumer credit.

While it is the smallest segment of consumer credit, the credit card industry is a major provider of financial services and a multi-billion-dollar industry. Credit cards provide access to credit and payment conveniences. They provide a means of cashless transactions. They serve as an interest-free loan from the time of purchase until the payment is due.

They provide customers with the ability to receive cash advances from automated teller machines. They provide customers with the ability to shop by telephone and on line, and they also provide an instant source of credit that is available without filling out forms or undergoing credit checks. Unlike cash, a lost or stolen credit card can be replaced, and there are liability limits for fraudulent or unauthorized charges. Credit cards also offer resources in cases of emergency, such as large repair bill or airfare home during a family crisis.

However, there are definite disadvantages of credit cards as well, such as credit card debt. It may be more costly and difficult to repay than other forms of consumer credit. The convenience of credit cards may tempt some customers to live beyond their means. It is also noted that excessive credit card debt and late payments can impair a cardholder's credit rating and make it more difficult and costly to obtain credit in the future.

It seems that an appropriate purpose of this hearing is to assess how the industry is balancing competing advantages and disadvantages of its product and how it serves its customers.

Mr. Chairman, again, my thanks for this important hearing, and I look forward to hearing from the witnesses, and I yield back the balance of my time.

[The prepared statement of Hon. Michael G. Oxley can be found on page 66 in the appendix.]

Chairman BACHUS. Thank you.

At this time, I recognize the gentleman from New York, Mr. Ackerman.

Mr. ACKERMAN. Thank you very much, Mr. Chairman, and thank you for holding this very important hearing. I appreciate the opportunity to hear from the witnesses today on a variety of issues having to do with credit cards.

There are several issues that I'd like to see addressed. One of them are the privacy notices that have gone out and how successful they've been. I know that I was deluged with them. I got about 40-some-odd different notices, and you could spend a lifetime or a career just reading them, and I think most people don't bother to read them, and I'd just like to know what the results have been so far.

I also want to hear about the terms of credit cards. The interest rates. I know my colleague before said shame on some of the credit card companies. I want to say hooray for some of the credit card companies. They have single-handedly put the Mafia out of the business of making loans at usurious rates.

I would like to know what the credit card companies think the limits are that they could soak the public for. I've gotten I don't know how many solicitations that have these once in a lifetime opportunities to borrow money and put it on your credit card. And you always know what you're getting into from the start, because it's really in very big type, sometimes right on the envelope, taking up the whole sides of the envelope, like 1.9 percent. This is a limited opportunity kind of offer. And then you read the small print. And you can't find the small print.

I'm not going to embarrass anybody today, because my original thought was to give everybody who was a witness here today, both panels, one of the solicitations and say find out the month that this expires, and you can't find it. I mean, it took me like 12 minutes to read one of them three times, and I had to get out my magnifying glass, because they have a type so small on the back page that tells you what the default date is, what the end date is, and the default rate. But you have to get out your magnifying glass and it's in print so small that that size type isn't even on the chart at your optometrist's office when you go for reading glasses.

And then the default rate on some of them that I just saw from one very prominent bank is 24.9 percent. I'd also like the answers to questions concerning why there is a different rate for people who are higher risk for not paying, and that rate is basically spread over the entire lenders' base and there's really very little attempt made to collect on that because you build that into the excuse for your next rate increase. And I just want to know what the limit is going to be and do you think that you're getting into the position of being in the area of what is usurious.

And finally, I'd like to know when a credit card company reports somebody to the credit reporting bureaus why it takes basically 24 hours to get that onto the report, and then you take as long as and sometimes longer than 3 months if that information was erroneous to remove it from the report of that agency. How do you explain that?

These are some tough questions, but I think the public has a right to know the answers to these and some other questions that I'll have later on. And I thank the Chairman.

Chairman BACHUS. Thank the gentleman. Are there any other Members on the Majority side?

Mr. Cantor.

Mr. CANTOR. Mr. Chairman, I would just like to make an opening statement.

Chairman BACHUS. Or an opening statement.

Mr. CANTOR. Thank you, Mr. Chairman. I would like to thank you for holding this hearing today on the credit card industry's treatment of its customers. As an opening comment, Mr. Chairman, I'd just like to point out an instance in which a credit card company not only treated its customers fairly, but in light of the events of the September 11th tragedies and terrorist attacks, went to great lengths to provide assistance to its customers and its community.

A case in point would be, Mr. Chairman, the Capital One Corporation. It happens to be the largest employer in my district. I believe that this company also has instituted policies which I believe could serve as models for the industry. After the tragedies of September the 11th, Capital One voluntarily took proactive steps to address the needs of its customers in these difficult times. They adopted a time standstill policy, charging no interest or fees for an entire statement cycle and established a hardship policy to allow for emergency lines of credit increases for people living within a 90-mile radius of both New York City and Washington, DC. Additionally, they suspended collection calls for two weeks in these areas.

For their other customers, Capital One backdated payments to compensate for mail delays and granted a higher number of fee waivers to customers with special needs.

But Capital One's greatest accomplishments I believe from the community from which I come in this time of national tragedy was its involvement in a nationwide telethon that occurred the Friday after the attacks. They created a 15,000 person call and payment processing center to handle the high volume of calls which were staffed by 7,000 Capital One employee volunteers. The company donated $100,000 to the American Red Cross effort, promoted blood drives at all their locations, and established the Capitol One Cares Fund which will match employee contributions up to $75,000.

But, Mr. Chairman, besides these acts, the company has worked very hard to ensure that the customers are satisfied and that there are many internal programs to improve the relationship with its customers that I point out could be a model for the industry. These programs range from Listen Up, which requires company executives to spend time each month listening and observing customer interactions in order to better understand the customers' needs. Customer Connection is a program that offers surveys to clients 24 to 48 hours after dealing with an associate in order to find out where Capital One needs to improve its services. The current results of this program have indicated that 83 percent of customers are very satisfied with the company's services.

In sum, Mr. Chairman, I would think that the efforts of Capital One in this time of national crisis and its continuing strive to have good relations with customers are examples of the good deeds and I think services that the industry is capable of. I'd therefore like to thank Capital One and the industry and its efforts to improve relationships with its customers. I am sure, Mr. Chairman, that out of this hearing we will also hear other ways that we can encourage industry to conduct like policies. I yield back. Thank you, Mr. Chairman.

Chairman BACHUS. I thank the gentleman from Virginia for those heartfelt sincere remarks.

At this time I'd recognize the lady from California.

Ms. WATERS. Thank you very much, Mr. Chairman. I'm very pleased that we're having this hearing. The full name of this subcommittee is Financial Institutions and Consumer Credit. All too often, we spend most of the subcommittee's time on the financial institutions part and not nearly enough time on consumer credit issues.

This particular hearing, which will examine current practices of the credit card industry, is long overdue. The credit card industry is rife with abuses and deceptive practices. Recently the courts and some regulators have acted to curtail a few of the most egregious cases. In my home State of California, the OCC imposed $300 million in civil penalties against Providian for deceptive marketing of mandatory credit protection and other violations. The OCC also imposed penalties against Direct Merchants Bank for downselling customers. Downselling is the practice of marketing favorable account terms to a customer, often preapproving the customer for these low interest rate accounts but then approving the customer for an account with higher rates and fewer benefits without highlighting these changes to the customer.

I am particularly concerned about late payment fees. These fees range from $15 to $35 and are generally imposed whenever a payment is late with no grace period. Reportedly, a number of institutions actually impose late fees even when the payment is received on the alleged due date because the cardholder agreement indicated that the payment must be received by an early morning hour of the due date, well before mail delivery is scheduled to arrive.

This is especially troubling in the current environment where mail delays are becoming increasingly common. While I am aware that some individual institutions have taken steps to waive fees and extend due dates in some cases, I believe that it would be appropriate for the regulators to impose a moratorium on late fees and over-the-limit fees that are likely to result from the delays in mail that are currently being experienced.

Alternatives to mail delivery are not necessarily better. Many credit card companies charge customers as much as $10 or $15 to process an electronic payment via phone. Even worse, I understand that at least one institution, my old friends at Citibank, does not credit these electronic payments at the time the customer authorizes the payment but delays crediting the account until the payment has been processed. Therefore, if a customer seeks to avoid a $35 late payment fee by paying $15 for an electronic debit, that customer may still be hit with the late fee if the bank doesn't credit the payment in a timely manner.

Furthermore, these late fees can trigger higher penalty interest rates, as high as 30 percent. These penalty rates can even be imposed in response to a late payment to another creditor. If this information is obtained from a customer's credit report, the customer has no ability to respond or explain the late payment which could be a disputed debt, a creditor mistake, or a case of identity theft.

Finally, I would like to hear testimony from both the regulators as well as the industry representatives regarding interest rate floors that many institutions impose. Every time that legislation is proposed to cap credit card interest rates, like the bills recently introduced by Congressman Salmon, the industry rails against these caps, claiming that they must have the flexibility to reflect the cost of funds in their products. However, now that the Fed has lowered the cost of funds considerably, many credit card customers are receiving absolutely no benefit from the interest rate reductions because their accounts have a floor or a minimum interest rate that will be charged.

Why is it that the industry considers interest rate caps a distortion of the market but imposes interest rate floors in order to prevent their customers from sharing in the lowered cost of funds? The reason the Fed has been reducing interest rates is to stimulate the economy. Stimulate the economy. Stimulate the economy. It seems to me that customers would have more money to spend if they were realizing the benefits of these lower interest rates. It seems to me this would be to everybody's benefit.

Now for those who say, you know, oh you just are attacking the credit card companies, or you feel Americans hold too much debt or credit and you would like to do away with the industry, that is not true. And that is one of the reasons I have introduced H.R. 2969, a bill that reinstates the tax deduction for personal interest, such as credit card interest and car loan interest. My legislation currently has 55 co-sponsors including Mr. Bereuter, Mr. Kanjorski and a number of other Members of the Subcommittee. It is my hope that even more of my colleagues will co-sponsor this legislation and that we will enact it this session, stimulate the economy by giving tax relief to consumers while preventing home equity stripping.

So in my estimation, if the credit card companies realized the benefit to themselves and to the consumers and this economy, they would lower these interest rates and support the idea that consumers could deduct the cost of the interest rates as tax deductions.

I would like to thank you, Mr. Chairman. I yield back the balance of my time and look forward to the testimony of the witnesses.

Chairman BACHUS. I thank the Ranking Member. Are there any other Members who wish to make opening statements? The gentlelady from New York and then the gentlelady from Indianapolis.

Mrs. MALONEY. Thank you, Mr. Chairman, for calling this hearing on how the credit card industry treats its customers. We are all sitting here because we have been elected by consumers. And I truly think we should hold more hearings that specifically address their treatment by financial service providers of all types.

I believe today's hearing is especially timely, given the events of September 11th. In the wake of the attacks, U.S. businesses have responded with an outpouring of charitable support and business breaks for my constituents in New York. These have included the waiving of late fees and other considerations by credit card companies. These are fantastic gestures by the companies that have offered them. While these good actors in the industry should be praised, I do believe that we should consider making the waiving of such late fees statutory.

As you would expect, my district office and my office here in New York have been inundated with case work related to the attacks. To this point, I can personally say that we have not received complaints from victims' families related to credit cards. In fact, most people I have talked to have praised the measures taken by financial service providers, especially insurers and individual banks that have worked with victims to extend credit and address their individuals concerns.

I look forward to comments by today's witnesses on the credit card industry, and I thank the Chairman for calling this hearing and I request permission to put the rest of my comments into the record. Thank you.

Chairman BACHUS. I thank the gentlelady.

Ms. Carson.

Ms. CARSON. Thank you very, very much, Chairman Bachus for convening this hearing so expeditiously, and I want to welcome all the panelists who are here today and to assure you that my comments are not combative, they're not accusatory, they're simply derived from the kind of constituent inquiries that my office receives both here and in Indianapolis.

For some years now, consumers have experienced and are experiencing a new system among credit card issuers in which small print can lead to big debt. Tactics such as penalty pricing, where fees and penalties have replaced interest earnings as the principal source of earnings for card issuers, and arbitration clauses and credit agreements have resulted in customers finding themselves trapped on a treadmill of debt.

As we move into the 21st century, credit card users are faced with an ever-growing myriad of hidden clauses which are designed to catch the consumer unaware. These include sudden changes in policies and rates, late fees, balance transfer fees, increases in annual percentage rates and mergers that change the rate and term agreements at a moment's notice. What these consumers are experiencing is a new system among credit card issuers called penalty pricing in which fees and penalties have replaced interest earnings as the principal source of earnings for card users.

Penalty pricing is a gold mine for credit card companies and unfortunately, perfectly legal. Credit card issuers are taking every advantage in current law to hook new customers with misleading promotions about teaser rates that start out low but can be jacked up as much as 24 percent if a customer is even one day late on a payment. Consumer groups report the grace periods are getting shorter for payment due dates. Many credit card issuers are eliminating payment leniency periods and slapping record numbers of new fees and penalties for every possible consumer lapse.

Students at my colleges and my university are saying that they open up their mail and there was a credit card, $10,000 limit. They're naive, immature, go out and run the credit card bill up. Their parents are being harassed. When they graduate from college, their credit is all screwed up. They can't do anything about that.

Finally, Mr. Chairman, let me mention another gimmick that my constituents complain about, and that is opening up a credit card bill, finding some company has charged their credit card for items that they have not received and know nothing about. And the problems that consumers incur trying to remove those bills, those charges from their credit cards and how the credit cards are making them go to a company that they don't even know exists to try to get those kind of charges removed.

Finally, the kind of sudden mail subscriptions that come to their doorstep for magazines that they did not order that appear up on their charge cards for charges.

Those are some of the kind of things that we're confronted with as Members of the United States Congress, and I believe that we can work out a solution that would be palatable both for the profit margin of the credit card company and be to the fairness and responsibility for the consumers who are credit card holders.

The bankruptcy filings in my district have skyrocketed, and it is all because of credit card debt.

Thank you very much, Mr. Chairman. I yield back the balance.

Chairman BACHUS. At this time, I'd like to introduce the first panel. The first panel is made up of regulators. We have Dolores Smith, who is the Director of the Division of Consumer and Community Affairs for the Board of Governors of the Federal Reserve System. And Elaine Kolish, she is Assistant Director of the Bureau of Consumer Protection, Division of Enforcement at the Federal Trade Commission.

Both our witnesses have testified before us before. Both of them are highly qualified to testify, and I think they are as informed as anybody at those two agencies in addressing the issues before us today.

So at this time I'd like to recognize Director Smith for an opening statement, followed by Director Kolish. We anticipate having a vote around 11 o'clock. Hopefully we can have both opening statements and start the questioning. But if we have a vote during your testimony, then we'll probably recess for votes. Thank you.

STATEMENT OF DOLORES S. SMITH, DIRECTOR, DIVISION OF CONSUMER AND COMMUNITY AFFAIRS, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Ms. SMITH. Chairman Bachus, Representative Waters, Members of the subcommittee.

Chairman BACHUS. And if you all will sort of pull those mikes up close.

Ms. SMITH. Thank you for inviting me to appear before you this morning. The Federal Reserve Board's Division of Consumer and Community Affairs carries out the Board's responsibilities for administering a number of consumer credit protection laws, including the Truth in Lending Act.

The Truth in Lending Act is the primary law governing credit cards at the Federal level. Disclosures about costs must be given with a credit card solicitation, when an account is opened, and with each billing statement.

Truth in Lending also requires that payments be credited on the date received. It limits consumers' liability for unauthorized use of a credit card, and it provides procedures for resolving billing disputes. Credit cards are also subject to various State laws that may regulate the terms of the accounts.

My written testimony gives a little background on growth in the credit card industry and includes attachments relating to a study entitled "Credit Cards: Use and Consumer Attitudes, 1970-2000", a study on credit card profitability and our consumer brochure on shopping for a credit card.

My oral remarks will focus on some of what we have learned from studies about consumers' attitudes toward credit cards. We'll describe recent regulatory changes that we made to improve credit card solicitations, and we'll mention the Federal Reserve's experience with consumer complaints and compliance examinations of State member banks.

First about consumer attitudes. The Federal Reserve sponsors or participates in a number of surveys that explore consumers' attitudes toward credit cards. I'll mention the most recent, carried out in January 2000. That survey reveals that consumers have mixed feelings about credit cards. About 40 percent of those surveyed believed that consumers would be better off without credit cards, and about 88 percent agreed with a statement that credit card companies make too much credit available to most people.

Consumers may have developed these negative views in part based on their perception of other consumers' difficulties rather than from their own experiences, because when asked, about 90 percent of the consumers with bank-type cards said they were generally satisfied with their own credit card companies and believed that they were treated fairly. They also believed that they could easily get a card from another company if they were not treated well.

The Board also has participated in surveys that looked at consumers perceptions about the ease of obtaining cost information for credit cards. In a recent survey, about two-thirds of consumers with bank-type credit cards said that obtaining information on credit terms is easy. However, many did find card solicitations offering a low introductory rate to be confusing.

I'll move on to describe our recent rulemaking. In response to concerns about solicitation disclosures, the Board last year amended the rules that govern solicitations to make them more helpful to consumers. The changes relate to disclosure requirements under the Fair Credit and Charge Card Disclosure Act of 1988. This law requires that the APR and other costs be disclosed in direct mail and other credit card solicitations. The purpose of the law was to ensure that consumers received key cost information about credit and charge cards early enough to permit comparison shopping.

Before 1988, consumers often did not receive cost information until they opened an account. The Act requires that the disclosures be given in a table prominently located on or with the solicitation. Over the years, as the pricing of credit card programs has become more complex, the cost disclosures provided with credit card solicitations also have become complex, particularly when multiple rates apply to a single program. And over the years, as the disclosures became longer, some card issuers chose to compensate by using reduced type sizes instead of allocating more space. In some cases, it became difficult for consumers to use the disclosure table to readily identify key costs and terms for comparison shopping.

In contrast, the promotional materials that accompany a credit card solicitation may highlight a low introductory rate in a large, easy-to-read type size.

Last year the Board revised its rules for credit card solicitations to make the required disclosure table more noticeable, simpler, and easier to use. These changes became effective on a mandatory basis on October 1, 2001, and consumers should now be seeing improved disclosures with the credit card offers they receive.

Card issuers must disclose the regular APR for purchases in at least 18-point type so that it is more prominent than any introductory rate. Also, disclosures must be readily noticeable. They automatically meet this standard if they are in at least 12-point type.

To take account of the complex pricing, cash advance and balance transfer APRs must also be included in the disclosure table.

I'll close by mentioning our experience with respect to bank examinations and consumer complaint investigations. The Federal Reserve conducts compliance examinations of about 980 State member banks. Most are small institutions. For the vast majority, credit card lending is not a significant activity. Of the banks that we examine, only three have substantial credit card portfolios representing 50 percent or more of the bank's total loans.

In our examination of banks that are involved in credit card lending, we find isolated instances in which the bank has failed to meet Truth in Lending requirements. We have not found any widespread practices that violate applicable laws or regulations.

The Board investigates consumer complaints against State member banks and forwards complaints about other creditors to the appropriate enforcement agency. The annual volume of complaints that we receive, including complaints about credit cards, has been increasing since 1997. Last year there were about 2,400 complaints filed with us regarding State member banks. Approximately 1,000, or 40 percent, were about credit cards. Of these 1,000, about 60 percent fell into three categories: disputes about billing errors; concerns about penalty charges, late payment and other fees; and disputes involving alleged errors in reporting consumers' payment history.

In the vast majority of complaints investigated, the bank was legally correct but made a good will reimbursement or other accommodation to the consumer.

Thank you.

[The prepared statement of Dolores S. Smith can be found on page 68 in the appendix.]

Chairman BACHUS. Thank you. Director Kolish?

STATEMENT OF ELAINE KOLISH, ASSISTANT DIRECTOR, BUREAU OF CONSUMER PROTECTION, DIVISION OF ENFORCEMENT, FEDERAL TRADE COMMISSION

Ms. KOLISH. Thank you. My name is Elaine Kolish. I am the Associate Director of the Enforcement Division at the FTC.

Chairman BACHUS. If you all would pull those mikes just a little closer.

Ms. KOLISH. Yes, sir. First I'd like to note that my oral statement represents my own views and not necessarily the views of the Commission or any individual commissioner. As Mr. LaFalce noted, the FTC doesn't have jurisdiction over banks, but we do exercise our jurisdiction over non-banks to stop deceptive practices very vigorously, bringing dozens of cases against marketers, telemarketers engaged in deceptive marketing of credit card offers and credit card protection services to consumers. In fact, just last week, we brought eight cases against people who were misleadingly marketing credit cost loss protection services.

But I'd really like to focus today on our recent case against Ira Smolev and a group of companies that he ran that sold memberships to discount buying clubs, known as Triad Discount Buying Service. The Commission brought this case as part of its overall crackdown on deceptive negative option marketing and free trial offers, and as part of our ongoing effort to ensure that consumers' credit cards are only charged for the goods and services that they want.

This case is particularly important because of the large number of consumers who found their credit cards charged up to $96 for a buying club they didn't want. Last week we announced that we've obtained a settlement with Mr. Smolev and his companies to pay $9 million to the FTC and to the more than 40 State Attorneys General who joined us in this action.

Although free trial offers can be a great way for consumers to try a new product or service without making a long-term commitment, they're only legal if the marketer is up front and truthfully discloses all the material terms and conditions. What happened in the Smolev case is that consumers didn't get the information they needed, and here's how it worked. Say you saw a TV commercial for a chicken rotisserie and decided you simply had to have it, so you call the toll-free number, provide your credit card number to pay for the product, and then you're told, as a thank you for your purchase, they'd like to give you a special offer—a free trial in a discount buying club.

These additional pitches are known as upsells, which is the telemarketer's version of the foot in the door. Getting one, two, three or even more upsells is becoming very common in telemarketing calls. Unfortunately, while the telemarketer touted the offer as free, risk-free, no obligation, the telemarketer failed to tell you adequately that it was your obligation to call before the end of that 30-day trial period to avoid having your credit card charged for a year's membership. And in many instances we found consumers got charged even if they said no to the free trial offer, and other consumers said they never even heard the pitch but they were charged anyway.

Adding to this injury was that the telemarketer you called transferred your credit card information to a third party, in this case, the Smolev buying clubs, without your knowledge or agreement. Under the settlement we've reached, as many as 275,000 consumers are going to get refunds of at least a portion of what they paid and the companies are going to have to dramatically revise their marketing practices to prevent future deception.

In particular, the order will protect consumers by prohibiting the defendants first from transferring credit card information to third parties, and second, from obtaining credit card information from third parties without consumers' knowledge and agreement.

The Smolev case is particularly troubling, because it shows that when marketers already have consumers' credit card numbers, they have the ability to place charges on consumers' accounts without their knowledge and agreement, and they can transfer this information to third parties who can do the same thing.

The FTC and the States have already brought a number of cases involving misleading free offers and dozens of cases involving other types of misleading sales practices involving credit card offers and credit card loss protection services. And we continue to actively monitor this area so that we can stop deceptive practices.

In addition, Chairman Muris just recently announced that as part of our review of the FTC's telemarketing sales rule, he will ask the Commission to consider amendments that would address abuses concerning pre-acquired account information, to ensure that such information is not used to bill consumers' credit cards for services and goods they do not want.

Let me close by saying that, as we do in all areas, we try to inform consumers about what they need to look out for when they get free trial offers so they can make informed decisions about whether to participate, and we encourage consumers who feel they've been misled to file complaints with the FTC. That information is extremely important to us in helping us target our resources on the worst actors.

Thank you for this opportunity to testify.

[The prepared statement of Elaine Kolish can be found on page 112 in the appendix.]

Chairman BACHUS. Thank you. At this time, we're going to recess for votes. We anticipate we will reconvene at twenty after. Thank you.

[Recess.]

Chairman BACHUS. The hearing will come to order. At this time I'm going to ask unanimous consent from the subcommittee that we allow one of our colleagues, Representative Chris Smith, to make a statement. Representative Smith of New Jersey has introduced legislation prohibiting credit card companies and other creditors from imposing late fees, raising interest rates or submitting adverse information to a credit bureau with respect to any consumer whose mail service has been disrupted due to a biological or chemical attack on America.

So at this time, without objection, Mr. Smith.

Mr. SMITH. Mr. Chairman, Senator Bachus, Chairman Bachus, thank you so much for this courtesy, because this is I believe to be an emergency that's occurring right now in my district but the potentiality of this happening in anyone's district or in proximity to their district is very, very high, so I want to thank you for this very kind courtesy that you've extended to me.

Mr. Chairman, I do appreciate the opportunity to discuss legislation that I've introduced which I hope will receive a thorough analysis and quick analysis and consideration by this subcommittee and the Full Committee. The proposal, H.R. 3175, the Late Fee Emergency Relief Act of 2001, would protect consumers from late payment penalties caused by mail delays resulting from acts of biological, chemical or radiological terrorism.

In the event of a terrorist attack that resulted in the disruption of mail, the legislation would require the Postmaster General to certify certain zip codes as being disrupted. This designation would be for a 30-day period, kind of like a grace period. During the period of disruption, consumers would be given 30 additional days to make their payments or mortgages, and they would be protected from having to pay late fees, higher interest rates, or suffering from negative credit information being placed in their credit report. Persons whose principal residence is located in these affected zip codes would be afforded this modest protection.

Mr. Chairman, I drafted this legislation after learning that several, hundreds of my constituents have already received late payment notices for bills that they had mailed on time but had not been received due to the crisis at the Hamilton Regional Post Office located on Route 130 in Hamilton Township, New Jersey. This post office is a critical hub for mail distribution. As a matter of fact, it has 44 different feeder sites that feed into it. It is a very large facility, and I've seen the trailer that is filled to overflowing with suspect or potentially contaminated mail. There are bills, there are remittances, there are checks that are sitting there that until it is screened and checked and cleansed will not get out of that trailer.

I believe that with the recent anthrax attacks on our postal system causing disruptions and delays in mail delivery, it is only reasonable that banks and creditors make reasonable accommodations for customers whose payments are delayed through no fault of their own.

This legislation is carefully crafted to provide a mechanism for temporary relief for consumers. It will not allow people to escape their financial obligations, because the protection from late fees, higher interest rates, and—and I think very importantly—negative credit information only lasts for 30 days. Moreover, H.R. 3175 under the provisions, the Postmaster General has the authority to continue to list affected zip codes if the mail disruptions are not ended within the 30-day window.

Mr. Chairman, I believe it is a reasonable solution, and I do hope that you and Members of this important subcommittee will look at it, and it needs to be marked up and be put on a fast track to help people like my constituents. Thank you, Mr. Chairman.

Chairman BACHUS. I thank the gentleman.

At this time we'll go back to our regular order of business. But Representative Smith, we have before us representatives of the FTC and the Federal Reserve also who regulate the credit card industry, and also MasterCard and Visa representatives are in the audience and will be testifying on the second panel. So I think you had an appropriate forum.

At this time we will turn to questioning our first panel. I want to read an excerpt from a *National Journal* article that was published September 8, three days before the terrorist attacks on our country. It says "Credit has played an indispensable role in American prosperity, helping to sustain this country through economic downturns and tide over families threatened by sudden misfortune, but it has also exacted harsh costs, leaving a third of low-income people in serous financial trouble and squeezing middle class families as never before. Yet there seems to be no end in sight. U.S. households continue to pile up more debt each year, dedicating ever larger shares of their income to keeping up with payments. Huge industries are being created to facilitate this borrowing and to collect from those who can't pay."

And this is the particular line, and I'm going to use this as a question to you: "Meanwhile, as the demand for more credit soars, Government is turning a blind eye to new lending practices that are worthy of Tony Soprano.'' Now the gentleman from New York actually mentioned the Mafia earlier and complimented the credit card industry by saying that they replaced the Mafia in lending money to some people and were obviously a much better alternative. But here is at least one leading publication saying that some of their lending practices are worthy of Tony Soprano.

And Ms. Kolish, I will say to you, you described a flim-flam operation that I think was despicable, which defrauded thousands of American citizens. The FTC got involved in that. But I'll tell you what raised my eyebrows. You said that they were required to pay back—the consumers got ''some of their money back.'' My question to you, why didn't they get all their money back and punitive damages?

Ms. KOLISH. Our goal would have been to give all the money back to consumers as redress. Unfortunately, four of the major corporations——

Chairman BACHUS. And would you pull that mike a little closer?

Ms. KOLISH. Unfortunately, four of the major corporations at issue in this case filed for bankruptcy, and so we had a very difficult time. You know, we had other creditors competing for this money as well. But the good news is, the FTC is getting over 50 percent of the bankrupt estate so that we got the most money we possibly could to give back to consumers.

Chairman BACHUS. Are there any criminal actions being brought?

Ms. KOLISH. Well, I couldn't say if there were, but it's possible that criminal authorities—we don't have the jurisdiction to do that ourselves—could be interested in following up on this, but I'm not aware of that.

Chairman BACHUS. Do you all work and cooperate with the Justice Department and State Attorneys General when you see lending practices that you believe really represent criminal—you know, to me, some of these activities are clearly illegal.

Ms. KOLISH. We absolutely do work with criminal authority and State Attorneys General. In the Triad case we just brought, we worked with more than 40 State Attorneys General, and in many other cases, we've worked with State and other Federal authorities to bring cases which have on occasion led to follow-up criminal actions. Sometimes criminal authorities have used the civil findings we've obtained as a basis for their criminal action so they can get additional relief.

And although we don't have jurisdiction over banks, that type of lenders, because of those concerns that you mentioned about low-income people being preyed upon when they don't have any money, we have brought dozens and dozens of cases against these telemarketers who are offering consumers guaranteed Visas or MasterCards when, in fact, they end up paying $169 and only get applications or nothing. So we devote huge amounts of resources to trying to tackle those types of fraud artists, because they are preying upon low income people who can least afford to lose that money.

Chairman BACHUS. In telemarketing, do you all have any guidelines or parameters on what calls are prohibited at what times of day or night? Is there any Federal law on that?

Ms. KOLISH. Yes. Congress gave us additional authority in the 1990s under the Telemarketing Act, and we issued implementing regulations known as the Telemarketing Sales Rule, which prohibits sellers from calling consumers before 8:00 a.m. or after 9:00 p.m. And it also specifies that telemarketers when they call you in outbound calls have to disclose up front the identity of the seller and the material terms and conditions of the sale.

They are also prohibited, for example, in these lending situations where they want people to pay a fee in order to get a loan—we call it advanced fee loan scams—they're prohibited by law from collecting any money up front when they say they're going to try to help people get a loan or repair their credit history. So it's very good, clear-cut relief and guidance under the rule that allows us to go to court and get effective relief from judges.

Chairman BACHUS. I had an experience I think many Americans have. I have an unlisted telephone number and I received a call on that unlisted telephone number that I don't even use on credit applications from really a well-known bank. And I asked them very nicely, I said, you know, I'm not interested, and I would appreciate you removing my name from your list. I have now gotten two more calls from them. They're very courteous when I tell them to please not call me again. They then call me again. Are there any requirements on them when I advise them please not to call me again?

Ms. KOLISH. Yes.

Chairman BACHUS. And these calls are coming in at disturbing hours. I mean, I consider 8:15 in the morning, you know, on a Saturday morning, is not a good time to call me. I don't really think on my unlisted telephone number there is a good time to call me. And I have a listed telephone number that has an answering machine too.

Ms. KOLISH. Right. Unfortunately, they don't have to use listings to make calls. They can do automatic dialing. They can reach all sorts of numbers, listed or not listed. The Telemarketing Sales Rule does have a provision that says if consumers ask to be put on their "Do Not Call" list, they have to honor that, and they can be liable for civil penalties under the rule if they don't observe the customer's request. So we would be happy to hear about what organization it is that has violated your request that they not call you in the future.

Chairman BACHUS. Thank you. And it was actually an organization that I took a 1.9 percent loan out on, and willingly, and paid it, you know, bought a car and then 6 months later, paid it off. But most people aren't in a position to use those things. There are some of us who take advantage of those and get some very low rates.

Ms. KOLISH. Well, with your good credit history, you'll probably get more offers.

Chairman BACHUS. But now that I've done that, I'm surprised they'd call me back really. Ms. Smith, let me ask you this question. And if you'd like to comment on that other one. But let me ask you a more basic question I think that we're all concerned about. Can Americans continue to load up on consumer debt without harming—it's harming themselves—but without it harming the U.S. economy? And I mean, are we there? Are we going to have some long-term consequences to our economy?

Ms. SMITH. Well, it's certainly something that we worry about, particularly in a period when there are rising levels of unemployment. But I really am not in a position to get into the economic aspects of this. But it is something to be concerned about.

Chairman BACHUS. At the Federal Reserve, do you know of any actual—how great is the concern? How great that it can fundamentally harm our economy? And are there any serious discussions about what the policy of the Federal Reserve or the national Government ought to be about growing consumer credit? Which as I said in my opening statement, a lot of Americans have a lot of things because there is consumer credit out there, and they're choosing, day after day, transaction after transaction, to take on this credit. So it's a willingness on the part of them.

Ms. SMITH. It is a willingness on the part of the consumer. I can speak on the consumer affairs side of it and not on the economic. But on the consumer side, certainly we worry about whether consumers are cognizant of the difficulties that they can make for themselves. And one of the things that we have undertaken over the past year in particular is to focus on financial literacy efforts in addition to consumer education generally to make sure that consumers have some awareness of the fact that credit offers many advantages but that it also has disadvantages for the consumer and that it's important to use credit wisely, whether it's from credit cards or other types of credit.

Chairman BACHUS. OK. At this time I yield to Ms. Maloney. Or actually, I think we were going in order of how people came, to Mr. Ackerman.

Mr. ACKERMAN. Thank you, Mr. Chairman. Following up on the "Do Not Call" list and unlisted numbers that the Chairman referred to, in New York State we have a law in which people are allowed to put their name on a list that companies are prohibited to call anybody on that list, and if they do, there's a very severe financial penalty. It seems to be working very well, because that cut down tremendously and for a while altogether on the calls I would receive on my unlisted number. But now some of these companies have figured out a way around it. They just move out of New York State or have the calls made from out of New York State.

I will be introducing legislation later this week to which any of our colleagues are welcome to join as original co-sponsors, that would set this up on a national basis, anybody who doesn't want these calls or finds these calls are unwarranted or unwanted can put their name on a list, and that list would be provided to all of these boiler shops. What would be your reaction to something like that on a national basis?

Ms. KOLISH. Well, the Commission has actually been thinking along similar lines, and that one proposal that is going to be considered during our review of our existing Telemarketing Sales Rule is to set up a national Do Not Call list. So that's a proposal we think will be coming out in the Notice of Proposed Rulemaking sometime shortly.

Mr. ACKERMAN. Thank you. You mentioned, I think it was Ms. Smith who mentioned in her testimony about the type sizes for the promotional rate and 18 points versus 12 points, and a lot of people aren't familiar with what that is. I marginally am, having been in the newspaper and typesetting business some time ago. But that being the case, there is nowhere on these promotional rules that you have here that you're coming out with that says how and where people have to be notified as to which month or how many months this rate will last. And I get a lot of these. Because I turn over a couple of cards every couple of months.

But sometimes it takes me a very long time to find out if this is a 2-month promotion or it ends in September, October, November, whatever it is. And usually that typeface is 2-point type, which is minuscule. Two-point type, and there's an asterisk, and usually, and we learned in school you put on the bottom of the page what the asterisk refers to. This is on three pieces of paper later on the back of something on a whole, must be 10,000 words on a 5 by 6 piece of paper to tell you what month it expires in, and sometimes it's 3 months later by the time you have this process approved, or if it's a longer period of time, the month before it expires—and you don't even know when it expires, they send you a whole bunch of checks attached to a piece of paper and say take advantage of your current special rate to buy gifts for Christmas or go on a vacation or whatever, and they give you the checks, and they make it very easy. And you don't know that you spend that money at your very low rate knowing that on your next billing state, that rate is going to expire. Are you going to have regulations to do something about that and make them put it on the same page?

Ms. SMITH. You should be seeing improved disclosures if you haven't already. I hope that some of these solicitations you are talking about came—you know, were as the result of earlier solicitations and not anything that is running currently.

I mentioned earlier that the Board had amended the rules having to do with solicitations and under the new rule, the 18-point disclosure of the interest rate, if it is an introductory rate, also has to be followed immediately by the expiration date. So that it might say 1.9 percent until December 31st, 2001.

Mr. ACKERMAN. That's what I wanted to suggest. It wasn't in your testimony. I appreciate that. It's a very good idea.

Ms. SMITH. It's in the model forms. Well, it's in the regulation, but then we also have model forms setting out how it would look.

Mr. ACKERMAN. I appreciate that. The most recent one I got on the 1.9 percent, by the way, this one was very good, because it tells you right up front that it's until October of 2002, and I guess they want you to know that because they're proud of it I guess taking advantage of the lower rates now.

Ms. SMITH. There are two actual requirements. There's one for the box that sets out the disclosures and that is where they have to use the 18-point——

Mr. ACKERMAN. That will be very helpful. Let me get in one final question if I may. That answer is very satisfactory. This is a problem that was experienced by somebody in my city, namely, me.

[Laughter.]

Mr. ACKERMAN. I signed up for something called Privacy Guard to see what it was, and for $69.95 it saves your life. It does everything for you. It'll protect your Social Security. It'll protect creditors from going after you. It'll notify you if anything bad is going to happen. It tells you exactly what to do, you know, where you stand with the Veterans Administration, if somebody questions your credit, they notify—all sorts of wonderful things. So I signed up for this to see what it was all about. And after several months, they sent me nothing. And then I saw it on my credit card statement, $69.95, which was the only charge I had. Otherwise, it was a zero balance. Then what happened, I called the credit card company, said I want to cancel this. They said you have to call Privacy Guard. I called Privacy Guard and they tell me, well, you know, did you get our packet? I said I received nothing and I'm not interested in it anymore and I want to cancel it. They said OK. They took all the information. A week later, I received their packet. A month later, I received another statement from my credit card company and I called them and I said, hey, this $69.95 is supposed to be off. I've canceled it. And they put a $29.60 charge, a $29 late fee and 60 cents for a cash advance. This goes up to $100, and I still can't get this straightened out.

The next thing, I'm in the middle of applying for a recasting of a mortgage for my home, and I get turned down. I don't know why, because I otherwise have a fairly exemplary credit history, and I get a copy of the credit report and it refers to me to this whole thing that refers to this Privacy Guard thing. It seems that my company that was intended to protect me I thought now turned me in for not paying for a service that I didn't receive, and when I called the credit card company, they said they would take it off and give me a credit for it. They no longer used Privacy Guard. They've had a lot of problems with them. They took it off, and I said would you call the credit reporting agency, because I'm trying to take advantage of the low rates for the mortgage. If it jumps back up another point or two, it's going to cost me a lot of money. They said we'll take care of that right away. Nothing happens. A month later and month later, nothing happens. I called the company, the credit card company, they said, "Well, we took care of it." I get up to the president of the company. I usually don't identify myself by my title. I want to be treated like everybody else—poorly.

[Laughter.]

Mr. ACKERMAN. Which I was. Nonetheless, I was disappointed. I spoke to the president of the company. He assured me he was taking care of it. I told him that I was told that it's going to take another 90 days. He said, "No. We will take care of it right away." He called me back and he was shocked, shocked, to find that he couldn't get it taken off for another 90 days because there's a cycle. There's a cycle. And it can go for 90 days.

Now I'm stuck in this trap of having bad things said about my credit to everybody who is inquiring about my credit for all this period of time based on something that could have been, if it was corrected in the time that the report was made, which was instantaneously. They report it. Within 24 hours, I got this black mark next to my name. And it takes I don't know how many months, but certainly in excess of three or four, to get this remedied. Do you have any regulations in mind to fix this problem? Or somebody who will handle my mortgage? That was a joke.

Chairman BACHUS. Not only as it deals with his problem, but I guess all Americans.

Mr. ACKERMAN. Yes. I cite myself as an example knowing that there are many, many people who cannot reach the president of the company and find out that he's shocked.

Ms. KOLISH. I'm very sorry you had such a disappointing and terrible experience. There are Federal credit rules that are designed to help consumers in that situation. One is the Fair Credit Billing Dispute Act which, when you have a charge on your credit that is one you didn't authorize, you can call and dispute it.

Mr. ACKERMAN. Yes. And they put down, until they figure it out, they leave it on your credit report and they say this is disputed by this S.O.B. who's challenging our authority, and it flashes like a neon light to anybody knowing that I'm now a troublemaker. So that becomes problematic, but they don't take it off. They put that on right away, but they don't resolve it for months. And even if you're agreed, and all three parties agreed this charge comes off, they physically couldn't get the reporting company to do it.

Ms. KOLISH. Yes. Under the Fair Credit Reporting Act, furnishers of credit reports are obligated to investigate and resolve disputed information within a set time period. I don't recall offhand what that time period is, so I don't know whether they exceeded the allotted time.

Mr. ACKERMAN. I believe it's 3 months. But that doesn't matter. It was resolved. It was resolved in 3 minutes after everybody spoke. But physically, they don't take it off.

Ms. KOLISH. Right. I understand. And unfortunately, the Commission gets lots and lots of complaints about fair credit reporting agencies.

Mr. ACKERMAN. I believe you do.

Ms. KOLISH. We've sued them all, too, unfortunately.

Mr. ACKERMAN. But how do we fix that? If in this computer world where we all have buzzers and beepers and we're sitting up here vibrating and lighting up and shaking and baking and everything, and they can get this on your credit report so the world knows instantaneously that you missed a payment, why can't they be just as quick, when they know that we were wronged, take it off?

Ms. KOLISH. I certainly don't want to be defending the credit reporting bureaus, but I might say that I am sure they are getting thousands of inquiries a day about disputed information.

Mr. ACKERMAN. I feel a lot better.

Ms. KOLISH. It may not be always clear as it is in your case that, in fact, it should be immediately removed. It may be that they have so many transactions they need a reasonable period of time to respond to and remove disputes, whether that time period should be shorter.

Mr. ACKERMAN. Don't miss my point. There is no longer a dispute.

Ms. KOLISH. I understand.

Mr. ACKERMAN. They made a mistake in putting this on or whatever and they can't take it off. I've abused my time I think.

Chairman BACHUS. We've almost had a hearing on this one problem. But actually if we have a follow-up hearing we might deal with this.

Mr. ACKERMAN. Could we have a hearing on this?

Chairman BACHUS. Yes, we might actually have—but I think this is a wonderful example of how disruptive one of these transactions can be to a citizen and can cause real problems, even in this case a citizen who has a high degree of intelligence and sophistication and ability, as Mr. Ackerman said——

Mr. ACKERMAN. I'm going to put that on my campaign literature.

[Laughter.]

Chairman BACHUS. Yes. With all these problems facing you, it could be a tough campaign too.

[Laughter.]

Mr. ACKERMAN. If all this gets out. Nobody's listening to this are they?

Chairman BACHUS. But what we'll do, the other thing, that 1.9 til October of next year——

Mr. ACKERMAN. That's a great deal.

Chairman BACHUS. Don't throw that away.

[Laughter.]

Chairman BACHUS. Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman. I won't take my entire 5 minutes. Just a comment and one quick question because I look forward to the next panel. I apologize for not being here for the entire time.

With respect to credit cards, just a comment. I received my first credit card when I was in college many years ago, and I had a wise man say to me that this isn't free money. And that wise man was my father who just got his first credit card about 5 years ago. My father has a sixth-grade education, is an immigrant to America, and he said to me, "now you understand when you use this, if you don't pay it off every month, you're going to be paying a whole lot more for what you're using this for?"

Now it didn't take a person with a high school degree or a master's degree, or a doctor's degree to explain to me the fundamentals about a credit card and the convenience of a credit card and how you pay for that convenience. And I am somewhat dumfounded by some of what we have heard over the past with respect to responsibilities of individuals who get credit cards. I was a freshman in college when I got that first credit card, and I got that first credit card, and I used it appropriately per my father's instructions and never have had a problem with credit or credit cards.

My question to you is—and I look forward to the second panel to talk more about that, my question to you two is, Mr. Cantor, in his opening statement, mentioned something about Capital One that I hadn't heard about with respect to the tragedies of September 11th. Are you aware of any other companies doing that as well, either of you?

Ms. SMITH. Only through the media.

Mr. TIBERI. Several others? Is it standard in the industry or a few companies?

Ms. SMITH. I wouldn't be in a position to say. All I know is what I have read about in the media about some companies that are exercising greater flexibility, perhaps not to the extent that Capital One seems to be doing, but generally in making efforts to be accommodating to their customers.

Ms. KOLISH. That's my experience, too, is only what I've read in the media so far.

Mr. TIBERI. OK. Thank you. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. LaFalce.

Mr. LAFALCE. Thank you very much, Mr. Chairman.

Ms. Smith, during the break I told you many of the questions I was going to ask you and so I'll try to reiterate them now. Maybe you've been able to talk with counsel. First of all, when did the Federal Reserve Board get the legal authority to define unfair and deceptive practices in the banking industry? Second, why hasn't it done so up to now? What discussions take place? Would you please respond?

Ms. SMITH. Yes. The FTC provision that gives the Board authority to prohibit unfair or deceptive acts or practices in commerce was enacted in 1975. And I would say that we have from time to time considered whether there are practices that the Board——

Mr. LAFALCE. So over the past 26-some years——

Ms. SMITH. Twenty-six years, right.

Mr. LAFALCE. ——You've thought about defining unfair and deceptive practices which you could have done at any time within the past 26 years?

Ms. SMITH. Yes. I would say that the Board has not done so largely because the Act does establish a fairly restrictive standard. The standard for prohibiting specific acts or practices as unfair and deceptive is one that was established by the courts and then ultimately was incorporated by the Congress into the statute so that before the Board could adopt a specific prohibition, there would have to be findings of certain things, including such things as the act or practices likely to cause substantial injury to consumers. This is something that would have to be documented, not——

Mr. LAFALCE. Wait a minute now. This sounds like an excuse to me, Ms. Smith, for negligence in not having acted. I think the Federal Reserve Board has been terribly remiss. If you want to go after a particular company, you have to have a factual finding, but if you want to promulgate regulations regarding what would constitute an unfair and deceptive practice within the industry, you don't have to wait until after the fact to make this generally applicable. You can say these are the type of practices that would be by definition unfair and deceptive.

And if by some strange stretch of the imagination you think that the law prohibits you from defining the terms of the law, well then anybody interested in consumer protection would say give me a change in the law. And I can't recall any Fed Governor ever recommending a change.

Ms. SMITH. Well, I'll take note of your concern and then we'll see if there is anything that we might recommend for changing the law. But that's the way we read it.

Mr. LAFALCE. Besides a change in the law, see if you can't do it yourselves. You've had 26 years to define an unfair or deceptive practice. This is not directed at you. I don't know how long you've been the division head. I don't think that consumer affairs have traditionally been a very important issue for the Federal Reserve Board. It's seldom that we have a representative other than a Governor of the Federal Reserve Board at any issue before this subcommittee. Maybe it's because they're not that concerned about this issue, or maybe they thought, well, this is so important we better have somebody who's technically knowledgeable. I'll let people make their own judgment as to why that's the case.

But another option is if the Fed can't become more aggressive is to take the authority away from the Fed. And maybe we should. Maybe the Federal Board should be interested in monetary policy and maybe the financial soundness of a bank, but maybe they should have nothing to do with consumer protection. Maybe it's just too alien to their large world concepts. And I may be coming around to that conclusion. I want to see what they do.

There are other financial regulators, though. There's the OCC, there's the OTS, there's the FDIC. There are State banks. We have coordinating mechanisms with respect to a lot of banking areas, safe and sound practices, and so forth. Is there any coordinating mechanism with respect to consumer abuses?

Ms. SMITH. Our coordinating mechanism is through the Consumer Compliance Task Force of the Federal Financial Institutions Examination Council, which does take into account enforcement matters and issues that come——

Mr. LAFALCE. Whoever they are. I mean, is there somebody like in your office that meets regularly with somebody in the OCC's office who's a counterpart?

Ms. SMITH. Yes.

Mr. LAFALCE. Is there a name for this coordinating council?

Ms. SMITH. This is the Consumer Compliance Task Force of the FFIEC.

Mr. LAFALCE. But who are the members of it?

Ms. SMITH. The members of the FFIEC itself are principals from each of the agencies.

Mr. LAFALCE. Who is the principal from the Fed?

Ms. SMITH. Governor Meyer is our representative from the Fed. Jerry Hawke from the OCC, and generally the chairman or director or the heads of the agencies. The Consumer Compliance Task Force generally represents the enforcement people. For example, our deputy director is on the Compliance Task Force, and his counterparts at the other agencies. They meet regularly, usually once a month. So it is something that is ongoing.

Mr. LAFALCE. Do you have any legal memo which defines the legal capacity of the Federal Reserve Board to promulgate regulations regarding unfair and deceptive practices in the banking industry? If you do, I would like to request a copy of that legal memo.

Chairman BACHUS. Mr. LaFalce.

Mr. LAFALCE. Yes?

Chairman BACHUS. Let me propose to do one thing. We're expecting a vote about 12:30. If we can go to Ms. Hooley and then Mr. Ford, and then I will give you a second round of 5 minutes.

Mr. LAFALCE. Thank you very much, Mr. Chairman.

Chairman BACHUS. I think that will fit in very nicely.

Mr. LAFALCE. That's more than fair. Thank you.

Chairman BACHUS. Thank you.

Ms. Hooley.

Ms. HOOLEY. Thank you, Mr. Chair. I have a couple of questions and a couple of follow-ups. When Representative Ackerman was talking about buying this policy that's supposed to protect you, can you tell me, do any of those polices really protect you? And do they do anything more than if we ask the credit reporting companies to send everyone a credit report once a year?

Ms. KOLISH. I'm not familiar with what this particular company promised to do for Mr. Ackerman.

Ms. HOOLEY. Well, I'm just talking about there are several companies out there that do this.

Ms. KOLISH. Right. A lot of companies are selling services that consumers actually could do for themselves, although there's nothing inherently illegal about a company offering to do it for you for a fee. And I imagine what these companies would do would be monitoring your credit report to make certain that there aren't wild and wacky charges appearing out of nowhere, and if they were to appear, to let the consumer know. So they might track for a consumer a variety of sources to let them know what's happening to their credit.

Consumers have to decide for themselves whether or not they want to pay the fees to get this service or do it themselves by requesting a copy of their credit report periodically.

Ms. HOOLEY. Wouldn't it be easier if we just required the credit reporting companies to send everyone a copy of their credit report once a year?

Ms. KOLISH. Well, that would be up to you. I'm sure consumers would appreciate it.

Ms. HOOLEY. OK.

Ms. Smith, what can consumers do to protect themselves against negative options and deceptive trial offers and deceptive credit card practices? What can a consumer do?

Ms. SMITH. Well, I think that some of the things that have caused problems in the past hopefully will be taken care of through the privacy regulations, for example, where institutions are having to inform consumers of their sharing practices with respect to information about the consumer where it's with unaffiliated third parties and giving consumers the option to opt out of that information sharing. That is something that should go a long way. I think that ultimately, consumers also need to just be mindful in their conversations with entities, such as Mr. Ackerman had, to know what is happening to them.

I think the difficulty sometimes is that no matter how careful the consumer is, that a company that is bent on taking advantage is going to do so. And then the consumer is left in the position of having to go back and try to get it corrected.

Ms. HOOLEY. But you don't plan on doing anything in promulgating rules, right?

Ms. SMITH. I don't know that we would be writing anything in this particular area. We are going to be looking at our Truth in Lending rules in the coming year, and so it could be—I don't know whether this will tie into anything that—whether it involves provisions where we might be able to make a change. It isn't clear to me at this time that there is.

Ms. HOOLEY. Just one last question for Ms. Kolish.Has the FTC prosecuted any cases involving identity theft? It is an issue I have been working on and care a lot about. And have we prosecuted any of those cases? And if so, can you tell me about any of them?

Ms. KOLISH. We don't have the authority to prosecute criminally the people who actually have stolen a person's identity and run up charges. Local police departments typically do that. We have brought cases against people who have provided a mechanism for that theft to occur by providing, for example, identity templates so people have all the information, they can download what looks like a valid license, for example, and substitute somebody else's name and address and thereby use their identity. So we have bringing cases against people who actually provide a means for identity theft to occur.

Ms. HOOLEY. And how successful have you been? Is that one or two cases or 100 cases?

Ms. KOLISH. We've only brought a couple of cases to date. It's an area we're spending a good deal more time looking at. Under Congress's authority, we actually set up an identity theft hotline, so we now have about 100,000 calls about identity theft and we provide counseling to victims as requested by Congress. And we're actually looking for ways that we can play an active law enforcement role.

Fortunately, there are so many criminal law enforcement authorities who are participating in our Sentinel database, an identity theft database, that we're able to get out this information to the authorities who have criminal authority, which would be the most effective way of tackling this problem, so they can get that information quickly and easily.

Ms. HOOLEY. As you're looking for ways, have you found any ways? I mean, you say you're looking for ways. Have you found any?

Ms. KOLISH. One of the ways is by looking at the template sellers so they can't do that. And also we're trying to make certain that people aren't sharing credit card information with others without permission, because that could be a means by which identity theft could occur. So in this case we just brought, one of the things the defendants are prohibited from doing is from sharing that information with anybody else. They can only use it for the transaction the consumer authorized. Because we don't people's credit card information floating around there without their notice and agreement, because that makes them more vulnerable to identity theft.

Ms. HOOLEY. This is a huge issue. I mean, literally, you cannot pick up the paper, you cannot look anywhere anymore and not see this problem just growing enormously. And it's something that hopefully this whole subcommittee and all of us can work together on.

Thank you. Thank you, Mr. Chair.

Chairman BACHUS. Thank you.

Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman. I won't be long at all. I would say to my colleagues on the subcommittee, I apologize for my tardiness, but Ms. Hooley, you raised several interesting and important points regarding credit scores and how consumers can access them. All of us have stories similar to what happened, what regrettably happened to Mr. Ackerman, including people who are not on this subcommittee.

The bill that I've introduced, and Ms. Roukema last year in the Banking Committee held a hearing on this matter. I'm not certain if the FTC or even the Federal Reserve Board were there. I do share some of the concerns, Ms. Smith, and certainly don't direct this at you personally, but I do share some of the concerns raised by Mr. LaFalce.

We've known this problem has existed for some time, and very little action has been taken to correct it for the majority of the public, the overwhelming majority of the public. But one of the bills, and there are several circulating. Chris Cannon from Utah has one, Chairman Bachus and Mr. Schumer on the Senate side has one, where we seek to provide a free credit report, Ms. Hooley, to every consumer. We give every consumer the opportunity to not only get a copy of a free credit report, and hopefully Mr. Bachus will give an opportunity for a hearing.

But we also allow for people who might have had a skirmish with a creditor for $100 or less to pay that off, to have it removed from their credit report and they'd be forced to enroll some sort of financial management class much like the departments of motor vehicles and public safety all across the country will allow you to do to mitigate or avoid any type of penalty.

Second, I know that before I got here it was raised by Ms. Waters and I believe one or two of my other colleagues regarding ways in which we can ensure that consumers don't face any undue pressure or unnecessary penalty because of the slowness in which the mail may arrive today. I have introduced something that would extend the grace period for 2 weeks for all consumers, excluding business loans, and we can certainly look to include businesses in this. I would not be opposed to that at all. But to allow for a 2-week grace period for the next 6 months that would allow consumers to avoid facing late fees or additional financing fees to avoid having their late payment reported to credit reporting agencies, and perhaps more important, to avoid having their rates raised or having other adverse actions taken against them by a credit company or a creditor.

It's my hope, Mr. Chairman, that we obviously are dealing with and confronting an array of issues here in the Congress, one enormous one later today, and I would urge all my colleagues to support the Senate-passed Aviation Security bill, and obviously we'll have to deal with the stimulus package shortly as well, but I do hope this subcommittee can take up these matters as quickly as possible and perhaps even allow for the Consumer Late Fee Relief Act to be considered, or at least to be put before the President before we adjourn for the year. And it looks like we may not adjourn before late November or early December now.

With that, Mr. Chairman, I yield back the balance of the time and hope that when we do have this hearing that perhaps Ms. Kolish and Ms. Smith both can come back and be a part of that panel. Thank you.

Chairman BACHUS. Thank you. At this time the first panel is discharged. The subcommittee is going to stand in recess until one o'clock. At that time we'll convene and we'll put on the second panel. That will give us an opportunity to have two votes scheduled at 12:25 on the floor. It will also give our second panel and other representatives and people in the audience a chance to make some lunch arrangements. And we will be back at one o'clock. We'll start promptly at one o'clock. Thank you.

[Recess.]

Chairman BACHUS. I call the hearing to order. I want to welcome the second panel. Frank Torres, Legislative Counsel, Consumers Union; Edward Mierzwinski, U.S. Public Interest Research Group; Elisabeth DeMarse, CFO, Bankrate Inc.; Robert Manning, Professor at Rochester Institute of Technology; Joshua Peirez, Vice-President and Counsel, Mastercard International; and Richard Fischer, Attorney at Law, representing Visa International. And you're with Morrison & Foerester?

Mr. FISCHER. Correct.

Chairman BACHUS. OK. Thank you.

We'll start, Mr. Torres, with you.

STATEMENT OF FRANK TORRES, LEGISLATIVE COUNSEL, CONSUMERS UNION

Mr. TORRES. Mr. Chairman, Members of the subcommittee, we appreciate the opportunity to be here today to discuss this very important issue for consumers across this country. But first let me say that, in light of the recent events, we are really grateful for all that you and this subcommittee and Members of Congress are doing in these challenging times and under these profound circumstances.

Many of us have friends who work up here on the Hill. We interact with offices every day. And the fact that you all are showing up to get the business of this country done is a true testament to all you, and we do appreciate that deeply.

Having said that, and having listened to many Members of Congress and the President and others saying that consumers should get on with their lives, to help the economy, to spend, to shop, to go out to restaurants. Many consumers are doing that—using their credit cards. It is more than appropriate that we have this hearing now to discuss some of the games that the consumers face every day in dealing with their credit card companies.

And just as companies are responding, and we heard some examples here today, Americans are also responding to the call, and they really don't deserve some of the treatment that they're getting from the companies. And unfortunately, it may be coming from the same companies that are trying to do the right thing during these tough, difficult times.

But I thought maybe as a way to pull things together and try to map out some of the issues that have already been discussed earlier today during this hearing, maybe I'll kind of follow a consumer through his or her life and their interaction with the credit card industry, starting with college students, or now perhaps even high school students, who are getting bombarded with credit card offers, with little or no underwriting, no parental co-signing required, and little or no financial education about how to handle his or her credit card debt.

We have one example of a credit card seminar that had a panel discussion on "you never forget your first love and you never forget your first credit card." You know, how to target kids to get them into your brand and keep them loyal to your brand. As far as no underwriting goes, even the Federal Reserve Board has recognized that lack of underwriting is an unsafe and unsound practice.

The problem comes when these students get into trouble. The University of Indiana has said that they lose more students because of credit card debt than they do for academic reasons. You get into all sorts of trouble. Bankruptcy rates among college students are growing. You can still get that auto loan or that home mortgage later on, but now if you're in the subprime market because you've been late on a couple of payments and you've got some things on your credit history, those types of loan products are going to cost you more. So the consequences are very dire indeed.

Once you become an adult, the game really begins. More and more we're finding that credit card companies are making the bulk of their profits from fee income. So they're doing a lot of things to game the system to generate more fees, and it's really not fair to consumers. I mean, it's one thing for businesses to make a profit because they're operating in a competitive marketplace, they're trying to beat their competition, and they're telling consumers what they need to know and they're playing fair. Unfortunately, that's not what's going on here in all cases.

They're shortening grace periods. They've got teaser rates going. Late payment penalties have now reached the level of $35. And it's no longer due on the day that it's supposed to be due, it's due by eight o'clock or ten o'clock in the morning. In addition, if you're late just once on a credit card, some of them are charging punitive interest rates up to 25 percent supposedly to cover the risk. Well, if you're late just once, how does a punitive interest rate of 25 percent that may never come back down again cover the risk for you? Some credit card companies, they're charging you that much even if you're late on somebody else's card.

We've also argued, along with consumer groups, that credit card companies should disclose how much credit costs you right on the statements that you get. A $2,500 balance, if you simply make the minimum payments, it could take you over 30 years to pay it off and it would probably cost you somewhere around $5,000 or $6,000 in interest payments alone.

Now at least the Fed has adopted rules to enlarge the fine print, but better disclosures won't necessarily stop some of these underlying practices.

Another area that consumers face all the time is when these institutions sell your data. And Capital One does this. They use your data to try to sell you, to try to upsell you various products. And they have sold in the past Privacy Guard products, and at one time sold membership in some of these discount clubs. And under the Gramm-Leach-Bliley Act, unfortunately, there's not much consumers can do to really say no because of all the exceptions there. So consumers really don't stand a chance.

Credit scoring has also been brought up, and that's something that we urge Congress to address, because Fannie and Freddie have found that up to 50 percent of consumers are paying more for mortgages because of wrong credit scores, and so Congress needs to take a look at that.

Another issue I'd like to raise in my short amount of time left is the fact that the Federal Reserve Board has lowered interest rates nine times since January. Credit card interest rates haven't even begun to track the Federal Reserve rates. Many consumers either have fixed rates or preset floors. So this is a huge jackpot for the credit card industry. The money isn't filtering down, the help isn't filtering down to consumers who could use those funds to help stimulate the economy. CardWeb says that this could amount up to a $10 billion windfall for the credit card companies.

Finally, I'd like to bring up the bankruptcy bill, merely because we really can't talk about the practices of the credit card industry without talking about what they're up in Congress fighting for even now, and we understand that there might even be a conference on the bill scheduled for next week. Despite all these practices that could potentially help contribute to people falling into difficult financial circumstances, pile that onto layoffs, little health care insurance and other things going on in the economy today, the only advice that we can offer Congress to respond to the urging of the credit industry to push forward on the bankruptcy bill is to just say no to it.

And a closing note—and I promise to close, is that there's been talk about perhaps some financial education, perhaps, you know, people just need to understand about their credit more. And I think consumers understand fully well that they've entered into an agreement with the credit card company. They expect to be charged an interest rate. They expect maybe to be charged some fees, and if they're late on a payment, they should be penalized. But what the credit industry is doing goes far beyond that. And all of the understanding and all of the consumer financial education in the world won't necessarily help consumers avoid some of the tricks and traps and really deceptive behavior that the credit industry does.

One example of that is in our magazine, *Consumer Reports* magazine, found that even if you find the small print—and they don't always make it easy to find it, consumers really can't understand everything that the credit card company says, because the credit card companies don't always tell you what they mean. A spokesperson for Fleet explained how it works to one of our reporters when she said that a fixed interest rate doesn't mean it's fixed forever. Another case against Fleet concerned a no-annual-fee card that within months carried a $35 annual fee. The reporter actually compared this to "Alice in Wonderland." I think it's worse, because at least Alice kind of understood that things were a little bit strange. Here consumers might be unprepared to really fully understand what they're facing.

So we do appreciate you having this hearing, and I look forward to answering questions and hopefully, working with you on this and a whole host of other issues like payday lending and other things that consumers are facing every day.

Thank you.

[The prepared statement of Frank Torres can be found on page 121 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Mierzwinski.

STATEMENT OF EDMUND MIERZWINSKI, CONSUMER PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you, Mr. Chairman. I'm Ed Mierzwinski, Consumer Program Director with the Public Interest Research Group's national office, U.S. PIRG.

We're pleased to be here to talk about abusive practices in the credit card industry. We think abusive practices by credit card companies are on the rise, and we're very pleased that you're holding this hearing today.

In April, PIRG released a major report called "The Credit Card Trap". That report was based on a survey of over 100 credit card offers, and in that report we document a number of the practices which have been brought up already today in Ms. Waters' opening statement and Mr. Ackerman's personal story and in some of the other discussions, so I won't go into them in detail except to say that we have a brochure for consumers called "A Road Map to Avoiding Credit Card Hazards" which I provided to the subcommittee in electronic form and I would like to make copies entered into the record as part of my testimony. It summarizes the ten worst credit card marketing practices that we are aware of, ranging from the use of deceptive teaser rates to charging consumers late fees even when they pay their bills 10 to 15 days in advance, as many of the witnesses have identified as a problem and also talks about in the report and the brochure the significant problem of negative option sales.

The FTC witness talked about their consent decree and settlement with Triad which is a very significant case on behalf of the FTC. I would also respectfully point out that several State Attorneys General have brought cases against regulated financial institutions for very similar practices, most notably the lawsuits against U.S. Bank first brought by the Minnesota Attorney General.

So rather than talking about the problems, which I think everyone else has brought up, I wanted to quickly summarize our platform for leaning up the credit card industry. And I think this is an industry that does need cleaning up. By the way, before I start, this is also available on our website, truthaboutcredit.org.

The recommendations that U.S. PIRG has to enact legislation to solve some of these problems are the following:

First, we believe very similarly to Congressman Smith of New Jersey that there should be a moratorium on late fee penalties. I absolutely think that the Congress should consider, strongly consider legislation to put a freeze on banks imposing late fees and then jacking up the credit card interest rates of consumers because of events related to the 9/11 terrorist attacks. And whether their mail has been intercepted or even whether or not perhaps they simply forgot to mail a bill, I think there ought to be a better chance, a second chance for consumers. And we strongly urge the

Congress to consider some legislation to suspend the use of late payment information.

And as has been brought out before, you don't just pay a late fee. You pay a late fee. Then your credit history is reviewed, and you could have your interest rate ratcheted up to a punitive interest rate. Third, you could even have your interest rate raised on other cards for being late to one card.

Second, we urge Congress to prohibit deceptive practices. And we have received numerous complaints about the deceptive practice of raising interest rates on a card because of an alleged late payment to another card. Therefore, we support H.R. 1060 introduced by Ranking Member John LaFalce and others to prohibit numerous deceptive practices by the credit card industry. This bill would also address the problem of preacquired account telemarketing or negative option marketing which the Minnesota Attorney General case addresses.

Third, Representative Sandlin of the subcommittee has introduced bills to cap interest rates. If the banks are not going to pass along Mr. Greenspan's reductions in interest to consumers, the Congress should cap interest rates, and Mr. Sandlin has proposed that in H.R. 3125, capping interest rates of credit cards at 12 percent.

Mr. LaFalce has an omnibus bill, H.R. 1052, to improve credit card disclosures and improve the marketing of credit cards to young people. In the past, bills have been proposed to require that consumers cannot be dunned by a credit card company if their bill is postmarked in advance of the due date. We think that the Congress should take another look at those bills which have been filed in past Congresses by Representative Hooley, Representative McHugh and others. Representative Pascarell has a bill that says there must be a minimum of 30 days to pay a bill before it is late.

One of the problems we have, consumers are not ripping off the credit card industry. Consumers are not trying to trick the credit card industry. Let's be very clear. The credit card industry is trying to trick consumers, and they're using the labyrinth of the Truth in Lending Act to get around fair treatment of consumers. As Frank pointed out, they are now saying that you bill is no longer due on the 30th. It's due by 10:00 a.m. on the 30th. If Congress is writing bills that are that unclear that the industry can cure some of the problems it was having in litigation by simply saying, well, we'll say the bills are due by 10:00 a.m. and then we'll check the mail at 9:00 a.m. That's unacceptable to me, and we need to fix the Truth in Lending Act, and the first step is I think to go after these deceptive practices.

The final couple of bills that I'd like point out that I think the Congress should address, Mr. Gutierrez last Congress introduced legislation to ban mandatory pre-dispute arbitration. Credit card companies are now sending out amendments to their contracts telling consumers that they no longer have the right to sue the bank. They no longer have the right to have their day in court if they have a problem such as the one that Mr. Ackerman so eloquently described.They're saying you've got to come to our kangaroo court run by the arbitrator of our choice and you lose your right to have a class action, you lose your right to go to court. I think that's unacceptable, and I think the subcommittee should hold hearings on Mr. Guiterrez's bill from the last Congress.

And finally, of course, we support the proposals by Mr. Ford and others to require that credit scores be part of credit reports and that credit reports be provided for free each year.

I appreciate the opportunity to testify before the subcommittee today and would be happy to take your questions.

[The prepared statement of Edmund Mierzwinski can be found on page 129 in the appendix.]

STATEMENT OF ELISABETH DeMARSE, PRESIDENT AND CEO, BANKRATE, INC.

Ms. DEMARSE. Good afternoon, Mr. Chairman and the subcommittee. Thank you for inviting me to testify before you as part of your exploring these current issues and the trends in the credit card industry.

My name is Elisabeth DeMarse, and I am President and CEO of Bankrate, Inc. We are based in New York City and Palm Beach, Florida. My company is the internet's leading consumer banking marketplace. We provide current rates and How To information and financial literacy to an average of about five million visitors a month on a range of consumer banking topics.

We survey current interest rates in over 170 U.S. markets, including at least one in every single state, and we ultimately connect those consumers with over 4,500 financial institutions. Bankrate has 30 researchers who survey 100 different financial products, including mortgages, auto loans, money market accounts, CDs, checking and ATM fees, home equity loans, and of course, credit cards. From 30-year mortgages in Miami to Anchorage, we can tell you where they are.

In addition, we provide this information to a network of over 70 websites, including America On Line, MSN, Yahoo!, Nasdaq and AT&T. Our data is distributed through more than 100 national and local newspapers, including the *New York Times*, the *Wall Street Journal*, and *USA Today*. And finally, we've been recognized for our efforts by *Forbes, U.S. News & World Report, Fortune, SmartMoney*, and many, many other publications.

So having monitored these rates and trends in the credit card industry for over 16 years, we're in a very unique position to share our point of view. Weekly, we survey over 800 different credit cards currently available to the public, including every card issued by the 100 largest issues and the 50 largest credit unions.

Over the last year we've noticed several distinct trends. While rates continue to fall, many variable rate cards have hit a floor, as has been mentioned several times today, where regardless of the actions of the tracking rate, they can go no lower. Probably about 70 percent of cards are fixed rate programs, 30 percent are variable rate programs. Of those 30 percent, 26 percent of the 30 percent have floors. We believe 19 percent of those cards have hit their floors. They can go no lower.

Second, card issuers are increasingly relying on punitive fees to increase revenue and profits. Fee income to the card companies increased from $4.8 billion in 1998 to $5.5 billion in 1999 and is now about 25 percent of the card company's bottom line. And in the wake of the 9/11 disaster and attack, these fees are very problematic and very troubling.

Third, the internet continues to level the playing field. It does allow, in our case, consumers free access to information, and they do have more ability to search around and find better deals if they can invest the time, and they have the opportunity if the invest the time to become better educated about what exactly is involved when they take on a credit card. Bankrate.com is designed to assist the consumer in that search, and that is, in fact, what we do.

Once again, thanks for inviting us to appear before you today, and I would be pleased to answer any questions you have.

Chairman BACHUS. Mr. Manning.

STATEMENT OF ROBERT MANNING, PROFESSOR, ROCHESTER INSTITUTE OF TECHNOLOGY

Mr. MANNING. Thank you, Mr. Chairman. I appreciate the opportunity to share my research with the subcommittee on what is increasingly important in the banking industry's policies that are leading to a segmented structure of the consumer credit markets.

This subcommittee and many of its Members have a distinguished record in terms of addressing and championing the interests of American households. I think it's important to point out that in this current period, we're talking about an unprecedented era of profitability for the banking industry. Nine out of the ten last years have recorded record annual profits.

In particular, I'd like to acknowledge the long-standing efforts of the Member from Buffalo, who due to my new academic appointment in upstate New York, will soon be competing for my vote in the next electoral campaign. Congressman LaFalce has certainly been passionate and a persistent advocate for working families and highlighting the increasingly common excesses and questionable business practices of the credit card industry.

In this context, I'd like to preface my remarks by saying that I typically teach seminars of 2 to 3 hours, so this is certainly going to be a race for me, and I've included a much more extended testimony to address the particulars of my testimony.

I'd like to address three particular issues. One is the trends that are ongoing int he industry that have affected the pricing structure, particularly the point that we are increasingly discussing, the issue of sticky interest rates. I would like to emphasize what is a profound change in the new post-industrial economy of the important role of the macro-economic management of the economy and how major money center banks are now dramatically shifting the ability of the Federal Reserve to pursue its traditional management policies.

The third issue I want to address is the issue increasingly referred to as Generation in Debt, and the role in which the marketing of consumer credit cards is playing such a critical role into the future generations as well as the savings rate of the American economy.

The last 20 years have featured the deregulation of the banking industry. And it's important to understand the promises that were presented to us: A wider array of services certainly associated with lower prices. What we've seen is a tremendous acceleration of consolidation and conglomerate structure of the industry where the top ten credit card companies control three-fourths of the market. And we've seen this as it relates to the shift in real rates that have been charged in terms of consumer credit, and I refer you to Figure 2 of my testimony, which shows that real interest rates approximately have nearly doubled over the last 20 years. And it's important to put this in the context of comparing it to the automobile rate and the corporate prime rate, which shows you how sticky the interest rates have been on the one hand on the corporate side and very fluid and highly elastic on the consumer side.

Also I want to emphasize the emergence of a bifurcated structure, what we are increasingly referring to as a second tier. Issues such as payday lending, where we're talking about consumers burdened with 20 percent interest rates per year, we're talking about the emergence and increasing integration of markets where consumers are charged 15 to 30 percent for a 2-week loan. And these are not just small lenders. We're talking about joint ventures with Wells Fargo and Cash America, and who would have expected that the Community Reinvestment Act might possibly be satisfied by the portfolio of high interest credit cards and maybe even payday loans that are offered in central cities?

Indeed, what's profound about the shift in the banking industry is going away from installment lending at fixed rates at fixed terms to revolving rates. The real question is, does the increased risk justify the much higher real rates?

Indeed, what I think is critical here is looking at this in the context of the ongoing discussion of the conference committee on the consumer bankruptcy bill where the emphasis has been on limiting the ability of Chapter 7 to liquidate unsecured loans. The real issue has been has the pricing structure of the industry in terms of consumer credit cards already priced in a much higher delinquency rate? Is this simply another way of price gouging? It's quite intriguing to me that in the discussion of Federalizing the possibility of security at the airports, we have not questioned the possibility of Federalizing debt collection, which is clearly a subsidy to the banking industry during this context of unprecedented profitability.

Also I want to emphasize that when we talk about consumer debt, it's not just the magnitude but the terms. And indeed, we have a real imprecision here where issues such as car leases, payday loans, and so forth, are not directly measured in terms of the total debt obligations of consumers. Indeed, in 1999, we now have passed the threshold where the debt levels of the average household exceed 100 percent of their discretionary income.

Let me finish my comments by emphasizing then the fact that as we've increasingly heard, the Federal Reserve's lowering of the interest rates has not been reflected in lower interest rates to consumers. What I'm seeing in my more recent research today is that both the tightening to small businesses, which are the primary motor of job generation, and also the tightening of households could further push us into a deeper and more prolonged recession. And I think this is very critical as we discuss what is the debt burden and how crushing it may be.

To conclude, the terms of the "Generation in Debt," what is striking to me is when I first conducted my research over 10 years ago is when we saw the marketing of consumer credit to college students, it was rare to see a student with $2,000 to $3,000 graduating in debt in the early 1990s during the recession. Most of that debt was attributed to the difficulty of their job search. Today for the first time, we're going to see students routinely with $5,000 and $10,000 in credit card debt, which is subsidized by their ability to rotate it into federally subsidized student loans, who are going to be entering a job market maxed out before they begin looking for a job.

What I think is striking about the credit card industry in discussing their efforts to educate and make more savvy consumers, is there's no discussion on savings. This, Mr. Chairman, is going to have a profound impact on the economy and society as we become increasingly dependent on foreign markets for savings, that the national savings rate as it has achieved a negative rate will have a tremendous impact on our ability to compete globally and also impact on asset formation and the ability of future cohorts to retire in the standard of living they've grown accustomed to. Thank you.

Chairman BACHUS. Mr. Peirez.

STATEMENT OF JOSHUA L. PEIREZ, SENIOR LEGISLATIVE AND REGULATORY COUNSEL, MASTERCARD INTERNATIONAL INCORPORATED

Mr. PEIREZ. Thank you, Chairman Bachus, Congresswoman Waters, Members of the Subcommittee. I am Joshua Peirez, Senior Legislative and Regulatory Counsel for MasterCard International Incorporated. We are a global payments company comprised of over 22,000 financial institutions of all sizes worldwide. I thank the Subcommittee for taking time today to consider how MasterCard and its members serve MasterCard cardholders.

When the payments industry started around 35 years ago, consumers had few payment options, primarily cash and checks, but nothing that could be used worldwide. Today a MasterCard cardholder can virtually travel the world with only a single piece of plastic and make payments almost anywhere. And people like their MasterCard cards. Why? Here are just a few of the reasons—convenience, choice and protection.

First, convenience. MasterCard cardholders can use a MasterCard payment card at millions of merchants. That means fewer trips to the bank or ATM and no longer having to worry about carrying the right amount of cash, having it stolen or losing it. A MasterCard cardholder need not even leave the comfort of home to shop the globe. It is no overstatement to claim that the internet would not be such a critical part of our economy were it not for payment cards.

The second reason, choice. The MasterCard system has also led to a great deal of choice through the vigorous competition with other payment systems, other payment forms, and among the thousands of MasterCard member financial institutions. Indeed, because of the innovation of MasterCard and its members, consumers can choose from literally thousands of card programs, thousands of flavors of MasterCard, if you will.

And third, protection. MasterCard is also pleased to offer its cardholders outstanding protections. For example, MasterCard has voluntarily implemented a zero liability policy with respect to the unauthorized use of U.S.-issued MasterCard consumer cards that is superior to what is required to law. Specifically, MasterCard provides U.S. MasterCard consumer cardholders with even more protection. A cardholder is generally not liable for any losses at all. This has greatly enhanced consumer confidence, especially with respect to online shopping.

It's also important to note that the use of MasterCard payment cards benefits more than just consumers. Approximately 22 million merchants worldwide accept MasterCard payment cards. Many offer discounts, co-branded cards and other incentives for consumers to use MasterCard cards instead of other payment forms. Why? Acceptance of MasterCard cards is more convenient and safe and often cheaper than other forms of payment for merchants. Naturally, the acceptance of MasterCard payment cards also increases the number of payment options available to consumers, thereby increasing overall customer satisfaction.

Importantly, MasterCard acceptance also greatly increases sales for a variety of reasons.

I stated earlier that people like their MasterCard cards. Well, they also like the service they get from their card companies. As discussed earlier in the testimony from the Federal Reserve, the recent Federal Reserve study illustrates this point; and I'd like to highlight just three of the findings from this study.

First, 91 percent of consumers who have bank-issued payment cards are generally satisfied in their dealings with their card companies.

Second, 92 percent believe card companies provide a useful service to consumers.

And third, 90 percent of bankcard holders believe they are treated fairly.

How many other industries can claim a customer satisfaction rate of 90 percent?

MasterCard also provides important consumer education programs, because we believe financial literacy is critical for individuals of all ages. Many of these programs are described in my written testimony.

MasterCard also continues to work with Congress and the Administration to improve consumer financial awareness. For example, MasterCard is a strong supporter of H.R. 61, the Dreier-Pomeroy Youth Financial Education Act, which would authorize the Secretary of Education to provide grants for youth financial education programs. We are pleased that the House and the Senate have each incorporated this bill in the larger education reform measure that currently awaits final action in conference.

MasterCard is proud of its record of offering cardholders and merchants highly beneficial and convenient payment methods. Quite simply, we have set high standards for ourselves, and we will continue to strive to meet them.

Mr. Chairman, thank you again for the opportunity to discuss MasterCard's commitment to its cardholders. I would be pleased to address any questions the subcommittee may have.

[The prepared statement of Joshua L. Peirez can be found on page 148 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Fischer.

STATEMENT OF L. RICHARD FISCHER, ATTORNEY AT LAW, MORRISON & FOERESTER, ON BEHALF OF VISA U.S.A. INC.

Mr. FISCHER. Thank you, Chairman Bachus, Ranking Member Waters, Subcommittee Members. My name is Rick Fischer and I'm here today on behalf of Visa.

Visa is the largest consumer payment system in the world, with over 800 million Visa-branded cards——

Chairman BACHUS. Push that microphone a little closer, please.

Mr. FISCHER. Yes, sir. Over the years, consumers have really embraced bank cards. In 1970 when I first started practicing on credit card issues, only 16 percent of U.S. families had bank cards. Today that number has increased to nearly 70 percent. This dramatic increase is not surprising, given the convenience and benefits these cards offer to consumers. They make remote transactions like internet purchases possible, and they serve as a flexible substitute for personal loans.

The credit card business is highly competitive. Card issuers offer literally thousands of competing card products with a wide variety of features to satisfy increasingly diverse consumer interests. Indeed, credit cards have become an important facilitator of consumer demand for products and services, and as a result, have fueled much of our economy in the last few years.

Under the Visa system, each bank establishes its own fees, its own finance charges, its own credit standards, and its own rewards programs when they exist. And each bank prepares its own disclosures and develops its own privacy notices. And these activities are closely regulated by existing Federal laws like those you've heard about earlier today, the Truth in Lending Act, the Electronic Funds Transfer Act, and the Gramm-Leach-Bliley Privacy Act for disclosure purposes. In fact, there are few activities today that are not already heavily regulated by existing Federal laws.

The Visa system also puts the choice on how to pay in the hands of consumers. Visa believes strongly that it is the consumer who should choose whether to pay with credit cards or debit cards or by cash or checks.

Card issuers realize that their success depends upon customer satisfaction, and they compete with each other in every aspect of the account relationship, including customer service. If a card issuer fails to meet expectations, cardholders can easily move their balances to another issuer. In fact, there are many secondary sources today that help consumers compare and evaluate credit and related products quickly and easily, term by term and feature by feature.

Visa also has long recognized that consumers are best served if they have a solid understanding of personal financial management. So Visa and its members have developed many programs to provide financial education to elementary, secondary, and college students around the country. These financial literacy initiatives, such as

"Practical Money Skills for Life," are discussed in my written statement.

And Visa has recently partnered with the Reserve Officers Association to provide helpful information on money management to military personnel being deployed in Operation Enduring Freedom and their families.

Visa has also been a leader in combatting fraud, including identity theft, for more than a decade. Fraud prevention protects merchants from fraud losses and protects consumers from higher prices caused by fraud. So preventing fraud is a top priority at Visa at its members, and I can report today that fraud in the Visa system is at an all-time low, even as Visa transaction volume has grown dramatically.

Most recently, and this was questioned before this panel came up front, Visa members have worked closely with law enforcement authorities in the aftermath of the September 11th terrorist attacks. And Visa members have been proactive in assisting customers affected by those attacks. For example, many banks have waived late fees and interest charges on customer accounts. One bank estimates that it has waived more than $15 million in fees and interest in the last month alone.

Another bank searched its records to see if any of its cardholders were victims of the September 11th attacks. For victims identified, the bank completely forgave the debts, even though it was not required to do so, because the bank wanted to do its part.

Overall, I have found that card issuers today are not asking what they must do to comply with the law. Instead what they're asking is how can they do their part, how can they help without being asked to do so.

I appreciate the ability to be here today and to participate in this panel, and I'm happy to answer any questions.

[The prepared statement of L. Richard Fischer can be found on page 153 in the appendix.]

Chairman BACHUS. Appreciate that. Now we'll start with questioning.

Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman, Members of the subcommittee. I think I'm going to start with Mr. Torres and Mr. Mierzwinski.

I don't know if you heard earlier when I talked about my father. My father and mother both are immigrants, and in fact, what I didn't tell you before was, my father and mother now use their credit card, even though they didn't have one until about 5 or 6 years ago, for about everything. And interestingly enough, my Dad thinks the credit card companies aren't very smart. The reason why he doesn't think they're very smart is he pays his bill off every month, and so he gets a little extended line of credit there, and then he also gets cash back—no disrespect to Visa or MasterCard. This is not a plug for Discover. But he gets a couple hundred dollars every year cash back, and he does all his grocery shopping and his gasoline purchases, everything. And he's making a little bit of money.

My Dad is an immigrant. My Mom is an immigrant. He has a sixth grade education. She has a ninth grade education. What am I missing here, Mr. Torres?

Mr. TORRES. I think that it's great that your parents are able to use the system and have a credit card, and some consumers, other consumers are able to do the same thing. But I don't think that that forgives, the ability of some consumers to do that, to understand the terms and the conditions that are imposed upon them, with the Discover card that your parents have, that doesn't excuse some of the other deceptive behavior that the FTC, the Office of the Comptroller of the Currency and the courts have found go on in the industry.

I mean, other consumers, not your parents, but other consumers get duped all the time. It started with teaser rates. We heard Mr. Ackerman talk about this Privacy Guard product. We've seen increases in late payments, not just the interest, not just the fees themselves.

Mr. TIBERI. Excuse me. I heard your testimony. What I don't understand is, for me, it's very simple. If I have a bill that comes in, a Visa bill that comes in, and I have 15 days to pay that Visa bill, and I don't make that payment in 15 days, why shouldn't I be charged a late fee?

Mr. TORRES. We're not saying that you shouldn't be charged a late fee, but shouldn't that late fee be fair in terms of if it's going to be—if the idea behind a late fee is to get you to pay your bill on time, that's fine. But to go beyond that, to say we're going to use this as a profit-generating mechanism, and on top of that, kick up your interest rate substantially, supposedly to cover risk, which I question whether or not that actually covers risk or is something more.

I mean, I think that if all consumers were in the same place as your parents are, we wouldn't be having this hearing to talk about the problems in the credit card industry and the practices that they impose on consumers.

Mr. TIBERI. And I'm not here to defend the credit card industry, but isn't there some responsibility for the cardholder? Can't you just say no? Is someone putting a gun to everybody's head saying let's get a credit card? Isn't it the responsibility for the person who applies for the credit card?

Mr. TORRES. I think you're right and I think Ed wants to respond, too. But another example that I didn't have a chance to get to was the fact that there's another credit card company that the OCC went after called Direct Merchants. They solicited business offering one type of card, and as it turns out, were giving their customers another type of card, charging them a processing fee that they didn't disclose that they would be charging, and then on top of that, when consumers called in to complain, they said, well, you've been upgraded.

Mr. LAFALCE. Would the gentleman yield?

Mr. TIBERI. Mr. Torres, you mentioned three times consumers can't understand, consumers can't say now. And I tell you, the household that I grew up with, "No" was used quite a bit. And I don't understand why the assumption is, is that all consumers are dumb.

Mr. LAFALCE. Would the gentleman yield?

Mr. TIBERI. I take offense to that as a son of immigrants. I will yield to the distinguished Ranking Member and head of the Italian-American Caucus.

Mr. LAFALCE. I thank the gentleman from Columbus, Ohio. Your parents are terrific people. There are a lot of terrific people who get duped. So far, your parents haven't. But you represent the great city of Columbus, Ohio, which at one time was the headquarters for a bank called BankOne that issued a few credit cards and had a few credit card problems. I suspect that your constituents probably had more of those credit card problems than most any other Congressional district.

Mr. TIBERI. Well, and again, my point is, is not to defend the credit card industry, but even my wonderful aunt, who lives in Niagara Falls, New York, has the——

[Laughter.]

Mr. TIBERI. And is a big fan of Mr. LaFalce's, by the way, pays off her credit card every month. Now again, she has a fifth grade education. And Mr. Torres, I still take offense to your remarks that consumers don't understand and consumers can't say no.

Mr. GRUCCI. [Presiding] The gentleman's time has expired.

Mr. TORRES. Could I respond to that?

Mr. GRUCCI. Please finish your statement. But the gentleman's time has expired.

Mr. TORRES. I don't mean to imply that consumers are dumb. Most consumers that I know are very bright. But what they're facing is an industry that might be a little bit smarter and might be a little bit able to maneuver a little bit better than them, than those consumers. And not every consumer is in a position to be able to pay off their credit card balances every month. We wish that that was different. But especially in these economic times when we've got a lot of workers laid off, a lot of people without health insurance, they're facing tough economic times. And it's my understanding from having worked on the bankruptcy bill that consumers work very hard. They tap into all of their resources to try to pay off all of their bills in the terms that they're given. What they don't expect is to be tricked and trapped and perhaps charged more than they should.

Mr. GRUCCI. Thank you.

At this time we'll turn to the Ranking Member for the Full Committee, Mr. LaFalce.

Mr. LAFALCE. My parents had less of an education that the gentleman's from Columbus, Ohio had. I was the first one to graduate from high school, go to high school in my family. Then I went on to law school, and so forth. And I have studied law in Philadelphia—a Philadelphia lawyer—and I have an unbelievable difficulty with so many of the practices. The practices are virtually impossible. They get everybody, no matter how intelligent you are. So that's not the issue. That's a phony issue. That's a phony argument.

The issue is the practices are designed to trap individuals. You know, they trap everybody, the most intelligent, and of course, the least intelligent too. And they're designed to do that. They're deliberately crafted that way to make money on human lapses or lack of compliance with technicalities. And sure, they are glad to get individuals to come in and say, "if you want to pay it off every single month in toto, and we'll give you 2 percentage points off at the end of the year" or, you know, "if you're a GM card, five points" or what have you, because they know that so many people are going to make so many lapses that they're going to make it up in fees and penalties plus. That's the strategy. That's the game plan.

And, you know, we ought to be aware of that. That's a reality of life. And there are just certain things that we ought to define as unfair, certain things we ought to define as deceptive. And we haven't done that adequately, either as a Congress or the regulators. And for us to try to just give one example of how a credit card can be used well, of course, a credit card can be used well. And I wouldn't want anybody in my family not to have a credit card, certainly at least for emergencies if not for the ordinary conveniences of life. But you don't want it to be abused either, or fall into the trap.

Now let me focus in on Mr. Peirez and Mr. Fischer for a little bit. It's the issuers who make these decisions for the most part as opposed to MasterCard or Visa. Is that correct?

Mr. FISCHER. That is correct.

Mr. LAFALCE. OK. But do you have any either compacts with your issuers regarding practices that they should have to adhere to that would not be unfair or deceptive, or do you have a set of best practices that you urge upon your issuers?

Mr. FISCHER. There is no compact as such, Mr. LaFalce.

Mr. LAFALCE. So as far as you're concerned, you let your issuers do whatever they want to? If they comply with the law, it's fine. If they don't, that's——

Mr. FISCHER. No.

Mr. LAFALCE. If they have deceptive practices or sort of deceptive, that's OK?

Mr. FISCHER. There is no way that Visa—and MasterCard can speak for itself—could possibly condone deceptive practices.

Mr. LAFALCE. I'm not talking about condoning it. I'm talking about allowing it or trying to do something about it by either including a compact that would be violative of the legal arrangements with you, or at the very least, a model which you would suggest they follow.

Mr. FISCHER. Without any question, the Visa brand is critically important to the company, and customer satisfaction is very important.

Mr. LAFALCE. Yes, but all these issuers that had enforcement actions brought against them or were found liable in the courts, they used MasterCard, Visa, Discover, and so forth. You know, I mean, they don't really care. How many times have you canceled the ability of an issuer to use MasterCard or Visa because of what you thought was a deceptive practice? Do you impose any penalties upon issuers who engage in unfair or deceptive practices?

Mr. FISCHER. Visa does not do that. Visa expects——

Mr. LAFALCE. Does MasterCard do that at all?

Mr. PEIREZ. Congressman, MasterCard issuers are required under our rules to follow the law and to assure that our system is not utilized for violations of the law or in an illegal fashion. So to the extent that issuers are——

Mr. LaFalce. One of the difficulties was is they'll always say in any settlement, you know, but we didn't violate the law. So we settled this in order to just get rid of the nuisance. And that's why I said in my opening statement earlier, there ought to be a law, or at least there ought to be a regulation. And, of course, it's taken me 7 years to get this hearing. I assume we're going to have a markup of my bills next week, but maybe I'm wrong. You know, it's taken 26 years and the Fed still hasn't promulgated regulations. You know, you can see why I get a little frustrated.

I mean, I think this hearing is basically cosmetic. I mean, this was a sop to me to be very cooperative with the money laundering legislation. Of course, that was my legislation, so it was easy for me to be cooperative with it. And I don't want something that's just cosmetic. I don't want us to have this hearing today and say, see, LaFalce, we gave you the hearing. Now what more could you ask for? A lot more. A lot more. And I'm starting with MasterCard and Visa.

What do you do about internet gambling? Now a lot of courts have said that internet gambling is ipso facto—I guess I told a funny joke there—illegal under the terms of the Wire Act. How does MasterCard and Visa handle internet gambling? Do you just permit it at will, or do you think it is illegal, or do you monitor what you consider to be legal or what you consider to be illegal?

Mr. Peirez. What I can tell you is what MasterCard has done. What MasterCard has done with respect to internet gambling is it has passed rules requiring notice to the participants of what's going on so they can be aware. First it requires that the site which is engaging in providing a gaming site give notice to the customer that, in fact, this is a gaming transaction that could be illegal.

The second rule requires the merchant when transmitting that transaction through our system to flag that transaction as an internet transaction and as a gaming transaction so that when the issuer then receives a request to authorize that transaction, the issuer can be aware of that. And MasterCard also, as I said, requires that its issuers not allow the system to be used for illegal activities. So to the extent that the issuers are able to tell that an activity is illegal——

Mr. LaFalce. Some issuers have said, we're not going permit our credit card to be used at any time for internet gambling, period, because we think that it is ipso facto illegal. I think Providian, for example, is one of them. Does Providian use MasterCard or Visa or both?

Mr. Fischer. It's really both, Mr. LaFalce. The difficulty here—and we'd be happy to sit down with you at any time to talk through it—is that it's not possible with technology today to block the transactions at the front end.

Mr. LaFalce. If you can't block them at the front end, you can stop the credit card. You can do this, because some issuers are doing it. They're blocking the use of credit cards at internet gambling sites.

Mr. FISCHER. Using the codes that have been established, if in fact the transactions are coded in that fashion, you can block them. When they come through for authorization, you can block them.

Mr. LAFALCE. Right.

Mr. FISCHER. That assumes they're coded properly. If they're not, you can't block them.

Mr. LAFALCE. OK. But, you know, if you've got 1,500 gambling sites and you code them all, you can block them all.

Mr. PEIREZ. I would emphasize that at this point in time, the majority, as far as I'm aware, of these gambling sites actually don't accept MasterCard payment cards or Visa payment cards directly for payment.

Mr. LAFALCE. What do they do?

Mr. PEIREZ. Usually the MasterCard card would be used to fund an internet account of some sort that can be used for a variety of purchases, not just internet gambling.

Mr. LAFALCE. So they get around it. You know, but if they can get around it, there's a way to figure out how to stop them getting around it if you'd work with us, if you wanted to do it. I mean, you know so much more about it than we do. If you wanted to stop it, if you wanted to ensure compliance with the law, you could. I mean, I don't think you're being very forthcoming here. I think you're sort of saying, well, you know, we're making money on it. As long as we're making money on it, you know, and as long as nobody's coming into court and charging us with anything illegal, you know, we'll let them get around the law this way. That's my interpretation of what you're doing.

Mr. FISCHER. Congressman, we've worked with many Members of this subcommittee as well as other Members of Congress and plan to continue to do so to try to find——

Mr. LAFALCE. Good. But nobody has been as active on this issue as I am, and you've never worked with me on this issue, so I don't know who else you've been working with.

Mr. FISCHER. Well, we'd be happy to work with you on this.

Mr. LAFALCE. OK. I'm wondering who else you've been working with on this issue, because I don't know of anybody else on this subcommittee who's been—maybe Chairman Leach.

Chairman BACHUS. Thank you, Mr. LaFalce.

Mr. Grucci.

Mr. GRUCCI. Thank you, Mr. Chairman. I'd like to address my comments to Mr. Fischer. Mr. Fischer, are you a member of the corporate offices of Visa?

Mr. FISCHER. I am not, sir. I'm outside counsel for Visa.

Mr. GRUCCI. OK. And I suspect that you're here because they didn't have anybody to send?

Mr. FISCHER. No. I've worked on credit card issues for 30 years, and there was a broad range of questions that the subcommittee ask to be addressed, and so they wanted someone here with the experience to come in and answer those questions for you.

Mr. GRUCCI. The questions that I have revolve around several things. First let me start off by just making an observation which leads to the question. With the Fed lowering interest rates and interest rates dropping on just about every other kind of consumer loan that's out there, from mortgages to automobile loans, why haven't the interest rates dropped on Visa cards? I wasn't aware of this until several people brought it to my attention back in the district, and then when I looked at my own Visa bills I said, yes, it's absolutely right.

The interest rates are still sky high, and it would seem to me that with all of the reduction in interest that your company ought to have taken a forward-looking approach and also dropped rates. Could you respond to that? And if you're not in a position to respond to any of these, I understand. I would then ask you to bring this back to those who can make those decisions at corporate since no one is here to represent them, other than you.

Mr. FISCHER. I'd be happy to try in the first instance to respond, sir. First, Visa itself sets no rates. There are 21,000 banks that participate, 14,000 of them in the United States. Each of them operates their own program, so each of them sets their own terms and fees. So to answer that question, we would have look specifically at the issuers.

In terms of programs that have variable rates that are actually tied to an index like prime, then of course, they would float. In other words, they would move up and down with prime. In particular programs, there may be floors and ceilings on them, but, in fact, subject to that, they would, in fact, float.

Mr. GRUCCI. Has it moved at all, the interest rates on your cards since the Feds had started lowering interest rates?

Mr. FISCHER. I can't tell you that, sir.

Mr. GRUCCI. OK. Would you find out from corporate if indeed that is the case? Also, could you answer the question about the credit cards that are issued to college students? I have several colleges and universities in my district and the parents are very concerned about the number of credit cards that their children are able to obtain through the mail simply by opening up their mail and it's sent to them with as much as a $3,000 limit on it, and finding themselves in some very significant problems.

Why would companies like yours send out those types of things without at least understanding that there are college students who may not be able repay those types of loans and then perhaps putting their parents in the kind of problem that they may face?

Mr. FISCHER. Well, first, as a parent of three children in college, I share your concerns perhaps even a little more directly in that sense. But, issuers cannot send out cards to students. They simply cannot do so. The Truth in Lending Act prohibits it under the current law. What they can do is send out offers which can be responded to. And I heard a comment earlier that cards were being sent out with no underwriting——

Mr. GRUCCI. Let me just interrupt you for a moment, because my son, who is college, got one to my house, where he resides. It was in his name and it was a $3,000 limit on it and he doesn't have a job.

Mr. FISCHER. And he received an actual plastic card?

Mr. GRUCCI. He got a plastic card in the mail, which I quickly proceeded to take away from him.

Mr. FISCHER. I'm sure that the relevant agency would like to hear about that, because it is, in fact, an illegal practice under existing law.

Mr. GRUCCI. And I'm very concerned about it also. I have one more question if I may, Mr. Chairman. I see my time is expiring. The question that I have is that it's come to my attention that Bank of America is planning on relieving the victims' families of their credit card debt. And the question that I have is dealing with interest. Do you think it would make sense—and I'll throw this out to the panel, whoever wishes to answer it, do you think it would make sense to add a provision in this package relieving the tax on interest that credit card companies would have to pay on a debt that's being relieved? Anyone wish to answer that?

Mr. FISCHER. Well, if no one wants to step on that, I will. Looking at any particular legislation, obviously, you need to see what's going on there. I've talked to probably 30 financial institutions about relief efforts, and none of them, for the most part in any event, have even asked for publicity, let alone a tax break. In other words, this is something that they simply wanted to do, given the special circumstances following September 11th.

If Congress was to turn around in that context and say, well, now we'll allow you to deduct it as well, you might find some interest. But I can tell you at least the institutions I've talked to are not asking for that, Congressman.

Mr. GRUCCI. Thank you, Mr. Fischer. I appreciate your being here and I respect the position that you have, but I wish you would bring back to your company that I'm a little disturbed that they wouldn't have a corporate officer present to be able to respond on behalf of the company. Thank you for your forthright answers.

Chairman BACHUS. Ms. Waters.

Ms. WATERS. Thank you very much. And I'd like to thank the members of the panel for being here. Since you have been here, you have heard a lot of criticism of the credit card industry. And you've been accused of abusive practices, you've been accused of all kinds of tactics which I know you wish to disassociate yourself from. Have you heard anything here today that would make you change anything that you're doing, Visa and Master?

Mr. PEIREZ. Congresswoman, thank you for the question. I guess my response would be that to some extent, the things that have been heard here today are no different from things that are said inaccurately about our industry from time to time. And I believe that often what gets lost is the great benefits that we bring to the American consumer.

Ms. WATERS. Have you heard anything that would cause you to change anything that you're doing now? I know about your benefits. I heard you talk about them. Have you heard anything here that would make you change anything you're doing or not doing?

Mr. PEIREZ. There are certainly things that have been said that we would like to consider that I will take back and discuss——

Ms. WATERS. Anything in particular?

Mr. PEIREZ. I can't talk to specifics, but there are certainly things and we can follow up with you.

Ms. WATERS. OK. All right. Well, I'm glad you're—sir, what about you?

Mr. FISCHER. Yes. Without any question, there's been an emphasis here on deceptive practices. And as I indicated earlier—and you correctly said—that's not something we or anyone here is going to condone. What it does emphasize is the importance of educating not only the consumers, which Visa has spent an awful lot of time doing, but perhaps the industry as well on these points, and that's what we'll endeavor to do.

Ms. WATERS. Thank you. Have you ever thought about, since you deal with so many members who are out there—and I guess you have contracts that you have with them to be a part of your organization—have you thought about standards for them? For example, some of these members certainly must have some practices that you don't approve of. For example, this mandatory insurance for credit cards that had to be dealt with in the legal system. Did you know about that kind of thing? I mean, what can you do to eliminate your members from having those kind of practices?

Mr. FISCHER. Well, as you heard earlier, we obviously can tell the members they must comply with the law. We can attempt to look at practices that raise questions and risks to the Visa brand. If you're dealing in an association like Visa or MasterCard, the one thing that you cannot do is be involved in pricing.

Ms. WATERS. If you find that one of your members is involved with deceptive practices, perhaps even illegal, you can tell them that they should be legal. What else can you do?

Mr. FISCHER. We certainly could tell them, assuming again that we are aware or believe that the practices they were engaged in were inappropriate, let's say even deceptive, that that is not good for them, it's not good for Visa, and it's not good for consumers.

Ms. WATERS. But you wouldn't tell them you wouldn't want them to be a part of your organization and kick them out, would you?

Mr. FISCHER. In a context if they were really violating the law, that might be a possibility.

Ms. WATERS. Would you like to see a piece of legislation that would help you? Legislation that would say if you have knowledge of illegal practices of one of your members and you do not within 30 days make them aware of it and warn them, that you could be fined, would that help you out?

Mr. FISCHER. I would prefer to invest that effort in education and also to help people to find issuers that perhaps are not engaged in those practices. The Federal Reserve Board indicated earlier that 86 percent of consumers understand their ability to move those accounts. I think that that would be the better result.

Ms. WATERS. Well, you know, the reason I asked is, sometimes it's difficult in business for people to say to those who add to the bottom line, change your ways or we don't want you, and sometimes you need some help. And perhaps we can find some ways to help you with that. But, of course, when we do that, I know you don't like legislation that kind of punishes you if you, you know, do not do certain things. But of course, some of us who are very concerned about some of these practices may want to try and help you out in some ways in accomplishing that.

So I raise the question so that you can be in the leadership in the forefront of trying to deal with some of these concerns.

Now is there a definition of when late fees start? When do late fees start? Do you have standards? If you say it's 15 days, when does the 15 days begin, when does it end? Is the time of day calculated into some of this in some way? What do you know about this? If I may have unanimous consent for 60 more seconds.

Mr. FISCHER. As the Federal Reserve Board representative indicated earlier—Dolores Smith—there are rules that say that you have to post payments as of the date they're received. There also are rules that say that there are a number of days in advance of that that that bill must go out. In other words, there must be a fair opportunity to get the bill out and have it paid. There is no law that I'm aware of that talks about times of days or any number of days beyond that minimum, which is about a 2-week minimum.

Ms. WATERS. Practices of member organizations, if the payment is not in by eight o'clock even though the mail is not received until 12 noon, then that becomes a late day. Do you know about any of that?

Mr. FISCHER. I do not.

Ms. WATERS. All right. And that's another area we may be able to help you. Maybe we need to define what 15 days are, what 10 days are, and maybe we need to decide that, you know, 10 days or 15 days are not enough. Maybe we need to step in here and help you out a little bit.

And finally, let me just conclude by saying, given the problems with the mail, could you envision a directive from your organization to your members to say let's have a moratorium on late fees for 60 days or 30 days or—what kind of leadership could you give? Are you desirous of doing that, or just the thought of it is just too much for you to even think about?

Mr. FISCHER. No. I'm pleased to say that what I heard from Representative Maloney and Representative Cantor is that Visa members are doing that without legislative guidance. In other words, they're looking at people who have been affected by this tragedy and they're voluntarily making the decisions you'd like to see them make under those circumstances by themselves.

Ms. WATERS. Some members are. But wouldn't you feel real patriotic if you were able to send out a big red, white and blue notice to your members saying we all ought to do this? Wouldn't that be nice and patriotic?

Mr. FISCHER. One of the wonderful things about competition is that when you have organizations who are doing that, their customers are going to remember. They will keep their customers, perhaps others will not.

Ms. WATERS. One of the good things about competition in addition to letting the marketplace work is seeing leadership that respects the marketplace so much that they provide recommendations, suggestions—can't make them do anything, but it sure looks good when from the top you're saying we think this would be a nice thing to do.

Chairman BACHUS. Mr. Fischer, you seem a little leery of the Ranking Member's offer of helpful legislation to assist your industry.

Mr. FISCHER. I'm always happy to sit down and talk with Representative Waters about any legislative proposal.

Chairman BACHUS. Thank you.

Mr. Cantor.

Mr. CANTOR. Thank you, Mr. Chairman. Mr. Chairman, I would just like to ask again those representatives from Visa and MasterCard, you know, my opening comment suggest that I do believe that there are members in the industry who are doing their part in these difficult times. I also concur with the notion that the industry provides a significant assistance to consumers who may not otherwise be able to access credit. I think it's an integral part of our economy without a doubt.

Just hearing some of the debate as I came into the second part of this hearing, I am concerned a little bit about the accusations and other things that have been stated here. But my emphasis—I would ask you if you could help us in learning about what the industry does, about what you know, as was said earlier, you know the industry better than we do, what has worked? What have your members done that has worked to promote responsible borrowing? If you can let us know how that has happened and if there's any way that we could learn about that to provide incentives for member companies to act responsibly.

Mr. PEIREZ. I think the primary thing the industry has done is engage in extensive consumer education efforts. MasterCard has engaged in many that are highlighted in my written testimony. Our members have done the same. But also importantly, I think it's worth noting that the industry's underwriting standards are extremely effective. Indeed, approximately only 1 percent of accounts in a given year default because of bankruptcy, and only another 2 to 3 percent of accounts default for any other reason.

So indeed, that's around a 96 or 97-percent success rate, which illustrates that, in fact, consumers who use MasterCard cards or Visa cards do so in a highly responsible fashion in which they are able, in fact, to make the payments they have to make.

Mr. FISCHER. Visa believes that education is essential. In fact, Chairman Greenspan said that in a presentation he gave just this past week. That's something that Visa has worked on now for over a decade. They have one wonderful program that's developed at both the elementary and secondary school level. Right now it involves almost 100,000 schools across the country, 37 million students. And ultimately, that is I believe the answer. That you can look at responses to particular practices that are not acceptable, but ultimately, it's education. It's understanding how to use these products, enjoy their benefits without getting into difficulty.

Mr. CANTOR. Mr. Chairman, one follow-up. Can you provide any details on the way that is accomplished? Is it through notice to the cardholders? Is it through calls? How is that most effectively delivered?

Mr. PEIREZ. I guess there are differing opinions on how education can be most effectively delivered, but oftentimes it's through people who the consumer trusts and knows already—their teachers, their parents, other students, if it's a college student education program. So empowering those entities that are already engaged in education to educate them on financial literacy is probably the most effective way, and we have been working with Members of Congress as well as with the Administration to try to bring more of those programs to the classroom and to campuses.

Mr. FISCHER. And Visa decided to go directly to the teachers. They decided if they were going to put something together, they wanted it to come not from Visa, but from teachers around the country. So it's something that's been tested by teachers, approved by teachers, and it's implemented by teachers.

There's a separate website. It does have at one spot a Visa logo, but that's all you'll see. Twenty-five thousand hits a day in terms of instruction, and I think that's very important.

Mr. MIERZWINSKI. Congressman, could I make a brief response to that?

Mr. CANTOR. Sure.

Mr. MIERZWINSKI. I just want to say, the consumer groups also support financial education, and we did not make it a priority in our testimony today to talk in great detail about it. But as I indicated, we have a brochure we've distributed thousands of on college campuses. Mr. Torres' magazine, Consumer Reports, is the largest consumer education magazine in the country, and the Consumer Federation of America has a major financial literacy program.

All that being said, I'm disappointed that the industry, although they sent their eloquent representatives of Visa and MasterCard here, that we don't have representatives of the companies that have, in fact, been under investigation by the OCC, by the San Francisco District Attorney, and by some of the other investigatory agencies around. And I wish, and I hope that the subcommittee will hold an additional hearing where Jerry Hawke or his litigators will be here to talk about some of their investigations to talk about some of the tawdry practices that the industry is engaged in. I think it's great they're engaged in financial literacy, but the fact is, a lot of the biggest issuers have been sued and have been caught.

Mr. LAFALCE. And some State Attornies General, too.

Mr. MIERZWINSKI. And some State Attornies General, as well.

Mr. CANTOR. I yield back the balance of my time, Mr. Chairman.

Chairman BACHUS. Thank you for those hard-hitting questions. Mr. Mierzwinski, let me comment on one thing for the record.

Mr. Hawke, we invited them to come to discuss those actions, legal actions, and I think appropriately, they said that because there's litigation ongoing they did not want to discuss the particulars of the case.

Mr. MIERZWINSKI. I'm sorry. I was referring to the settled cases.

Chairman BACHUS. Is that right?

Mr. MIERZWINSKI. If they're not settled, if they're ongoing——

Chairman BACHUS. Their response to us was that there was litigation ongoing.

Mr. MIERZWINSKI. OK.

Chairman BACHUS. Obviously, if there's been a final adjudication, that wouldn't be a good——

Mr. LAFALCE. Mr. Chairman, if you would yield?

Chairman BACHUS. I yield to the gentleman.

Mr. LAFALCE. I could understand not wanting to discuss the particulars of a case in controversy or if as part of a settlement there's an agreement to have a quiet period, but surely we could call in each and every regulator to discuss what the practices of the industry have been at large with respect to unfair and deceptive practices. Surely we could call them to find out what regulations they have articulated to deal with that, what enforcement mechanisms they have.

Chairman BACHUS. Sure.

Mr. LAFALCE. Surely we can call them in to find out whether they think there are some gaps in the law that need filling, and so forth.

Chairman BACHUS. Well, let me say this.

Mr. LAFALCE. So I would think the next hearing you have on this, we could have those individuals also to discuss those issues.

Chairman BACHUS. I'm telling you what his response was. Now if the litigation has concluded, obviously that wouldn't—and we'll go back and explore that further.

Also, as Mr. LaFalce said, they wouldn't have to discuss the details of the ongoing litigation. They could discuss their efforts. And I think you bring up a good point and that perhaps would be a good follow-up hearing.

Mr. MIERZWINSKI. Great.

Chairman BACHUS. Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Mr. Chairman. I want to ask the first question of Mr. Frank Torres with Consumers Union. What could be done so that all of the credit card companies would have to make sure that the people they send the credit card actually in the mail are not college students nor children in grades K through 12? I have two young daughters under 10 years of age, both are frequent fliers. And evidently they have their frequent flier card and their names were bought in some list, and so they received cards for $3,000 line of credit.

My colleague just talked about him being concerned about his college student son receiving one for $3,000. This is a problem. And we need to stop it and stop it quickly. So what could we do in Congress to put a stop to it?

Mr. TORRES. Well, one way you could do it very quickly is to amend the Gramm-Leach-Bliley Act and truly give consumers some privacy. Because you're exactly right. Probably the reason why you're getting the solicitations is because somebody sold a list to somebody else and you're unable to stop that or prevent it at all. So that's one of the things that you can do.

The second thing to do to try to stop the solicitations is to really ratchet down on the marketing practices of the credit card companies. Make them do their homework as to, you know, if they're going to be sending out these things to the world, don't reward them by passing a bankruptcy bill.

Don't reward them by not doing anything about some of their deceptive practices. Instead say if a parent comes into the regulator with one of these solicitations targeted to their kids, because a credit card company doesn't want to be responsible for who they're sending out all these solicitations to, enable somebody to bring stuff penalties against those credit card companies. I mean, it's a free-for-all out there. And unfortunately, the flip side to this is, I kind of question whether or not there's really competition in the marketplace, so if your son or daughter may be get the solicitation and they may get it for a low rate, but they may not qualify for that rate. So, that's a little bit off the tangent, but I think you get my point.

But the first thing you can do is really protect people's privacy.

Mr. HINOJOSA. Well, what if we made the first $5,000 or the first $10,000 of their purchases free so that they wouldn't have to pay the credit card company as the penalty?

Mr. TORRES. That certainly would be one——

Mr. HINOJOSA. That would get their attention, wouldn't it?

Mr. TORRES. That would certainly get their attention.

Mr. HINOJOSA. Thank you. The next question is to Richard Fischer at Visa. I've received a number of letters from my constituents in my Congressional district regarding the extremely high late fees charged by credit card companies. Apparently in some cases, the payment due date may fall on a holiday or a weekend, and the customer is assessed a late penalty if payment is not received before that date. And sometimes the amount of the penalty is greater than the minimum payment required.

Are there any industry standards that can be set up so that this doesn't happen?

Mr. FISCHER. There are no industry standards in the sense of Visa-set standards. Obviously there are rules, though, in the exiting law in terms of how you treat payments. And as you heard earlier, a payment must be processed, it must be handled as of the date of its receipt. If you have a payment, as I understood your question, sir, that was received on a Friday and not applied until the following week, that would be inappropriate under existing law.

I'd be happy to sit down with you, look at the individual complaint, see if we can't resolve the matter. Visa, of course, would not have set any of those fees or practices, but if there are issues to be dealt with with individual members, I'd be happy to intercede for you.

Mr. HINOJOSA. I would like to invite you to come to my office when they let us go back into Longworth and sit down with us in my office so that we can try to be able to answer some of these letters and give them good accurate information.

Mr. FISCHER. Be happy to do that. May I respond to one other question? In terms of your two daughters, did they actually receive a card?

Mr. HINOJOSA. There was a card in the envelope. It was instant approval for their credit.

Mr. FISCHER. Congressman, you have asked the question, what can Congress do? On that one, Congress has already done. The practice of sending out a card to somebody who's not asked for it is illegal today under existing law. They can send you an invitation in that particular context, but if they actually sent you a card—or your daughters a card—that's illegal under the law today. Congress has dealt with that already.

In terms of your question about the first $5,000 in balances, if your daughters—I'm sure they would not do this—but if they were to go out and use those cards, none of it could be enforced, not the first $1,000, not the first $5,000, none of it. They're under age. They shouldn't have had the cards in that instance without parental intercession, and in that context, there would be no liability for them.

Mr. HINOJOSA. Thank you. I have no other questions, Mr. Chair.

Mr. LAFALCE. Would the gentleman yield? Could we follow up on that for a second? Under what law? Does it depend upon the State law?

Mr. FISCHER. No, no. This is the Federal Truth in Lending Act. It has a provision in it dealing with the——

Mr. LAFALCE. If they sent the actual card?

Mr. FISCHER. Yes.

Mr. LAFALCE. OK. Good.

Mr. HINOJOSA. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you. Mr. Fischer, you and Mr. Peirez talked about consumers having a choice, being able to choose between products and that they have the right to go from one bank to another to choose products. Recently a court found that membership rules of both Visa and MasterCard that prohibit their members from offering other cards violate the Sherman Antitrust Act.

The judge agreed with the Justice Department that as a result of exclusionary rules, American consumers have been denied the benefits of credit and charge cards with new and varied features.

The court also concluded that small businesses and other merchants were harmed by the anticompetitive practices of Visa and MasterCard. Pretty clearly, some of the practices of MasterCard and Visa restrict competition, do they not?

Mr. FISCHER. We do not believe so, sir. The decision you talk about is a lengthy one. It's over 150 pages. It's very complicated. We think they got the first half of the decision right. And in that part of the decision, nearly 70 pages talks about all the competition in the industry and how valuable it is.

The second half of the decision we think went off in the wrong direction in terms of membership rules. It's something that we're looking into. The judge has asked for orders, recommendations on the order. We've given those. We're waiting for a final ruling in the case, and then we'll make a decision accordingly.

Chairman BACHUS. Mr. Peirez.

Mr. PEIREZ. I think Mr. Fischer covered most of the points. Certainly the judge's decision does emphasize the tremendous amount of competition and does speak to the various types of cards that are available to consumers as a result of it, and the ability of consumers to switch among cards. And similar to Visa, we are awaiting the judge's final judgment.

Chairman BACHUS. Both Visa and MasterCard, you tell a bank if you want to market Visa and MasterCard, you can't offer other cards, right?

Mr. PEIREZ. We tell members that if they want to be a member of MasterCard and be able to issue MasterCard cards that, with a few exceptions, they are not able to participate in other systems.

Chairman BACHUS. They can't offer other cards to their customers, right?

Mr. PEIREZ. They are allowed to offer Visa cards.

Chairman BACHUS. But only Visa or MasterCard? Is that right?

Mr. PEIREZ. There are some other exceptions, but in large part, that's correct.

Chairman BACHUS. That's restrictive, I mean, is it not? Whether you agree with it or not, it's restrictive. You're restricting their right to offer other products to their customers.

Mr. PEIREZ. It's important to remember that these members as well as MasterCard itself have spent billions of dollars over 30 years developing the MasterCard system, the good-will associated with it.

Chairman BACHUS. Let me ask you this. What if Coca-Cola spent billions of dollars developing that product, what if they told grocery stores they couldn't offer anything but Coca-Cola products? They couldn't offer Pepsi. They would be anticompetitive, wouldn't it?

Mr. PEIREZ. I don't believe that there's a parallel there. I don't believe that we do that. We certainly allow merchants to accept any and all cards. We certainly allow consumers to carry and use——

Chairman BACHUS. Wait a minute. You allow? Oh, you allow merchants to accept, but not your client. You don't really have control on what merchants do.

Mr. PEIREZ. What we ask of our members is that if they want to participate in the MasterCard system, they have loyalty to that system, and that they not engage in participating in other systems that diminish the value of MasterCard.

Chairman BACHUS. You mean you're asking them in the name of loyalty, you're saying you can't offer other cards?

Mr. PEIREZ. We're asking them if they want to be a member of MasterCard, to be a member of MasterCard and to abide by all MasterCard rules, including the MasterCard competitive programs policy, which I believe you're referring to, that limits their ability to participate in certain other programs.

Chairman BACHUS. Does that have any benefit to the American consumer?

Mr. FISCHER. We certainly believe it does. What's important to recognize is this matter is in the court today. It's not the first time. The same rule was dealt with in the 10th Circuit, looked at all of the practice, found it perfectly appropriate.

Chairman BACHUS. Mr. Fischer, you said you think it does benefit consumers?

Mr. FISCHER. To have a healthy system, a healthy Visa system, absolutely I think it benefits consumers.

Chairman BACHUS. Oh, have a healthy Visa system?

Mr. FISCHER. Absolutely.

Chairman BACHUS. You think that if they were able to offer other cards, it would——

Mr. FISCHER. It's not the issuance of the cards themselves. It is the entry to the system of someone who is looking only to destroy it, and that's the concern. But if you'd like to sit down, Chairman Bachus, at any time and talk about it, we'd be happy to do that.

Chairman BACHUS. And let me say this. I have tremendous respect for your intellect and your judgment, as a former attorney, I mean I've heard you testify. I've heard you testify on privacy. Very impressed with your grasp of the issues, so I respect your opinion. I know you're here on behalf of Visa. But I would be interested in doing that.

Mr. Torres.

Mr. TORRES. Mr. Chairman, may I respond to some of those questions? First of all, we think that the judge's ruling in the Department of Justice case is very important, especially in the aftermath of Gramm-Leach-Bliley, where the whole idea of that law is to foster competition and allow banks and financial institutions to offer a wide range of products, and we didn't see why a bank shouldn't be allowed to offer any card product, not just American Express or Discover or whoever, but some maybe new upstart company that would compete on the basis of interest rate, that perhaps wouldn't do some of these practices that we've discussed today.

The other thing—and since the idea of control over what merchants do has been raised, the merchants have filed their own lawsuit against the MasterCard and Visa networks for forcing them to, in order to continue to accept the Visa and MasterCard credit card product, also have to—they're trying to force the merchants to also have to accept the debit card product or the check card, it's the same thing.

The problem there that the merchants are facing is that they're being charged the same rates to accept the check card that takes money directly out of a consumer's account as they do for the credit card products, which is up to 2 percent of transaction, from my understanding, which is a tremendous amount that they end up passing along to consumers, so it's costing them a lot of money. So they've gone to court claiming that's an anticompetitive practice as well.

Mr. LAFALCE. Would the Chairman yield?

Chairman BACHUS. I don't know if that's the 2nd Circuit Court of Appeals case.

Mr. FISCHER. It is.

Chairman BACHUS. It is? That's what we're referring to?

Mr. LAFALCE. Mr. Chairman, I think we're getting onto an issue now that wasn't the initial focus of the hearing, which were basically credit card abuses, but I think it's extremely important and it's rather amazing to me that I can't recall in all my days on the Financial Services Committee a hearing regarding the practices of MasterCard, Visa, and so forth. We have left it to the courts. I don't know that the Judiciary Committee has. Maybe they have. But I don't think we have. And I certainly think that it's worthy of a future hearing in and of itself. What is the law? What have the practices been? What have the courts ruled? And what's the impact on the consumer?

We talk about the issuers of the credit card as opposed to MasterCard or Visa, but who owns MasterCard and Visa? Who are the real owners? Are some of the issuers also the owners? I think that's a question worthy of pursuit.

Mr. FISCHER. Could I have the opportunity to respond to just one point so that the mischaracterization isn't left?

Chairman BACHUS. Certainly.

Mr. FISCHER. This is about the suit that Mr. Torres was talking about. As I indicated in my oral testimony, one of the fundamental goals of Visa is choice for consumers. We put a lot of products out in the marketplace that have the Visa brand on it. We believe the consumer ought to choose what brand, what product that they use at a location.

The merchant—we had a lot of discussion about deceptive practices, and I'm not saying that that's what this is, but the merchant puts that sign out on the front door, invites me to in to use my

Visa card, and when I get up to the checkout stand they say, now wait a second, you can't use that Visa card. That's what that case is all about. We think that it's good to get to the merits rather than the procedural things now, because to take away that consumer choice. We've just been talking about consumer choice right along in that particular context. If the merchant wants to incent the consumer to use that other card, the credit card, the debt card, as we've heard earlier, in that particular transaction by a cheaper price, fine. But to say they can't choose is not something that we think is appropriate.

Chairman BACHUS. So you're saying that in the Wal-Mart and the other retailers which brought that lawsuit, what they were doing was actually discriminating against certain——

Mr. FISCHER. I'm saying what they're doing is taking away consumer choice. And any way you look at it, if they're saying you can't use certain payment products with the same brand on it, then that's taking away consumer choice.

Chairman BACHUS. And I think that case will go through. But it's interesting. I mean, there are always two sides to every story. Are there any questions from Members? I'll allow a second round of questions. We're going to have a vote in about 5 minutes and we'll conclude the hearing upon the calling of that vote or before, but I'll let Mr. LaFalce have additional time.

Mr. LAFALCE. Thank you very much, Mr. Chairman. An awful lot of the questions have been addressed to Mr. Peirez and Mr. Fischer regarding MasterCard and Visa. And we haven't really called upon Mr. Manning, Ms. DeMarse, Mr. Mierzwinski, Mr. Torres. And so I think the first thing that I want to do is ask the four of you, are there any issues that we've discussed that you would have liked to have commented on as we went along? Mr. Manning? Professor Manning, I'll call upon you first.

Mr. MANNING. First, there has been a lot of lip service about education, and certainly—aside from assessment quality, just like there's duplicitous advertising policies with cars, there is also duplicity in terms of what kind of education, whose interest it serves. I have yet to hear the term "savings" which was the cornerstone of the Puritan values of the society even being broached here in consumer credit.

We haven't at all yet looked at the efficacy of what is to be taught to young people and why it hasn't been taught and why suddenly it should be taught. The whole issue of the Visa Bucks program which specifically targets 10-, 11- and 12-year-olds, we have yet to discuss the influence it has in shaping a consumer culture and whether they should even learn the value of savings over debt.

And particularly surprising is we haven't addressed at all the line that's been crossed of the multi-million dollar contracts that are now being offered to universities where the yield on those contracts are directly related to the indebtedness of their students and that there aren't even any provisions for education that go along with that contract.

Mr. LAFALCE. Let's talk about that a little. But I also want, in connection with that, speaking of education, if a student uses a credit card and incurs some indebtedness, the student will go into bankruptcy and discharge that debt, correct?

Mr. FISCHER. Of course. Yes, sir.

Mr. LAFALCE. Now suppose it is a Government-guaranteed student loan? Now that's not dischargeable in bankruptcy is it?

Mr. FISCHER. It is not.

Mr. LAFALCE. What practices does Sallie Mae have with respect to the issuance of either MasterCards or Visas for the purposes of consolidating your indebtedness and getting a Government-guaranteed student loan using a MasterCard or Visa?

Mr. FISCHER. I'm aware of no such program.

Mr. LAFALCE. Mr. Peirez.

Mr. PEIREZ. I am also aware of no such program.

Mr. LAFALCE. I'll not pursue that at this point. But let's look into that. Mr. Manning, did you wish to make any further point regarding either the educational institutions and the fact that the payment they get is directly related to the amount of indebtedness incurred by the credit cards that are issued? And of course, they usually enter into exclusive marketing arrangements on campus with certain either—usually issuers. Is that correct?

Mr. MANNING. Well, I think we've seen a lot of lip service paid that there is less tabling and marketing directly visible on campus, but ignoring the fact that the marketing that's occurring is far more effective in getting credit cards to younger and younger students.

Mr. LAFALCE. Somebody mentioned, gee, we would not permit Pepsi-Cola or Coca-Cola to have something that's exclusive of the other at a grocery store. But in schools, for example, Coca-Cola and Pepsi-Cola do enter into exclusive arrangements with school districts and they pay them so much so that only their pop can be sold in a school for the next decade or so, which is a separate issue.

Chairman BACHUS. Actually what they do, they put their machines in there, and because it's their machines. But they don't prohibit them from——

Mr. LAFALCE. Well, I think they have exclusive arrangements. In other words, they give the school districts X dollar amounts if over the next 10 years no machines other than theirs can be in there.

Chairman BACHUS. Oh, yes. I'm not condoning it.

Mr. MANNING. I would certainly think that it's striking. I've been using the estimate that I expect by the end of the decade the billion dollar payola of the top 300 schools will be receiving approximately $1 billion per year, and I have yet to see any of those funds appropriated toward effective educational programming or any kind of debt refinancing in the context that we know that with the civil rights movement, with the emergence of a large surge of new immigration, we have a tremendous increase in first generation college students who are most vulnerable, most susceptible, and least likely to have parents who have had experience with credit cards and therefore find themselves at the very margins of the ability to cope with extra levels of debt and then force themselves out of college.

I think these are critical issues as we talk about a just and better educational system that the role that credit cards are increasingly playing today.

Ms. DEMARSE. Thank you very much. I do have a couple of things I'd like to share. I think we're in an unprecedented situation right now because of 9/11 and because of the economy.

Mr. LAFALCE. Because of what? I didn't hear you.

Ms. DEMARSE. Because of 9/11 and because of the economy. There have been nine rate cuts this year. It is not following through. We are not getting the benefit of this economic stimulus because so many of the cards are fixed-rate cards. Sometimes they're 7.5 percent cards, which are good cards, but most of them are 14 percent or way above the 5.5 percent basis.

And it's just not trickling down. And it's going to be worse because of the 9/11 situation. The industry's reaction to slower mail and late payments. We've interviewed a number of banks as a result of this request, and the consumer is asked to be very proactive. It's entirely on a one-time basis. The consumer has to request to have the late fees waived. It's initiated by the consumer. You must seek out help from your lender.

We haven't come across an institution that has decided to go across the board and waive the fees. And in fact, what we found is that the consumer has to be prepared to send in a copy of their data check to prove that they put it in the mail on time. And who knows? The check may still be in a post office somewhere mangled someplace.

So if you could depend on the credit card companies at this point——

Mr. LAFALCE. The thing that gives me pause, let me just tell you. One of the things I like to do whenever we have a day when Congress is not in session is just walk in the small little towns in my district. And I usually try to make a stop at the post office in a village of 1,000 people where the one postal official will, of course, in a week, meet everybody in that village.

And I say, H.L., what's going on? You know, what are they interested about? And they tell me—I'm not making this up now—telling me how irate people are about the fact that they are paying late penalty fees, around $30. And, you know, a postal officer in a village of about 1,000 says "I get about 30 people per week who come in and want to send something air mail special delivery, return receipt requested, just to avoid a late payment because it's cheaper to spend the $5 than the late payment." And he says, "but of course, the complaints I get about people who haven't done that are enormous." So they usually do that because they incurred a late payment fee the previous month.

And this is almost a constant. Whenever I go to the post office, everybody at the post office will recognize me and they'll come up to me and they'll start airing their complaints. And the late fees are one of the greatest complaints they have. And they're there for that purpose, of getting the check in the mail, air mail express, return receipt requested, and so forth, just so they can avoid that late payment. This is a huge, enormous problem. That's just one—one—of the many, many, many problems.

Either the issuers have their heads in the sand—and I don't think that's true. I think they know exactly what they're doing. It's just they're making money doing it. It's their way of making money. And so long as neither the legislators nor the regulators are doing anything about it, they'll bear the burden of a few isolated complaints as long as they can continue making money.

Chairman BACHUS. I thank the gentleman.

Let me conclude. I'm going to submit a question to you in writing to the consumer panel. And let me tell you what that question is. I see Director Smith from the Federal Reserve still in the audience. The Federal Reserve did a survey and asked American consumers who had credit cards if they were generally satisfied with their credit card services that they were receiving. And over 90 percent, according to their survey, over 90 percent of those with bank-type cards were generally satisfied with their dealings with their own credit card companies.

I guess my first question would be, do you agree with those findings? Do you think they're skewed or do you think they're wrong? And if they're right, how does that square with your assertions that there is widespread abuse of the American consumer by credit card companies?

Mr. MIERZWINSKI. Well, I know you have to go vote, so we will certainly take a look at that Fed study, Mr. Chairman, and we'll respond in writing to it. But I can tell you, a lot of those 10 percent have called me on the phone or sent me a letter. And they're very, very angry, as are Mr. LaFalce's constituents in the little village, and as the readers of the Bankrate.com website, and as the thousands of students Professor Manning has interviewed personally.

There are significant problems. I want to commend you for holding the first hearing on this industry. It's a massive industry. I don't think there's been a hearing since Joe Kennedy held a hearing on college credit card marketing in 1994. So I hope you'll have additional hearings in this series. Thank you.

Chairman BACHUS. Thank you.

I'm going to wrap it up right now. I do want to say this again concerning the Internet Gambling Prohibition Act and the provisions in that, because there continues to be things said by people that, I think, simply do not understand the provisions in the bill. What that bill will give, it will give financial services companies a list of specific internet sites, and it will ask them to prohibit payments to specific entities. It will identify those entities. It will identify those locations.

It was again said today that it will be hard for banks to determine whether or not a certain site is being used for internet gambling. Obviously, banks aren't in the investigative business. What they will receive under that litigation, the Attorney General, pursuant to court injunction, will simply say to them, you cannot transfer money to specific sites. They'll give a location and a name of that site.

I wanted to clarify that again. And it won't do anything beyond that. It also will not make any duties on the bank to determine what is legal or illegal or what site is legal or illegal or how those sites are operated. It will simply identify those sites and ask that you not transfer money to those sites.

This concludes the hearing, and I appreciate all the witnesses' testimony.

[Whereupon, the hearing was adjourned.]

A P P E N D I X

November 1, 2001

OPENING STATEMENT OF CHAIRMAN SPENCER BACHUS ON CREDIT CARD INDUSTRY PRACTICES NOVEMBER 1, 2001

The Subcommittee meets today to examine credit card industry practices, particularly as they relate to the treatment of cardholders.

The ready availability of credit in our country has had many beneficial effects, fueling economic growth and making the American Dream more accessible to many low and moderate-income consumers. But the American Dream has become a nightmare scenario for many of our citizens who find themselves and their families overextended and saddled with thousands of dollars in ever-escalating debt. Particularly as our country struggles to come out of its current economic downturn, it is entirely appropriate that this Committee take a hard look at credit card industry practices to ensure that the financial stress that many consumers find themselves under is not needlessly exacerbated.

Fact evidence paints a powerful story in tracing the growing reliance of American households on credit cards. Last year alone, credit card companies extended $3 trillion in credit to American consumers, nearly double the levels of just five years ago. The total amount of consumer credit card debt now exceeds $500 billion. Americans are bombarded on an almost daily basis by credit card solicitations, which come through the mail, over the Internet, and in those dreaded phone calls at the dinner hour -- aggravation that is mentioned often by my constituents.

Like most parents of college age children, I have a particular interest (financial and otherwise) in the aggressive tactics used to market credit cards on college campuses. The statistics in this area are also telling. Almost one-quarter of college students actually get their first credit card before they even leave high school. Not surprisingly, the past decade has witnessed a 50 percent increase in the proportion of people under the age of 25 filing for bankruptcy.

I have always subscribed to the view that the government should not be in the business of saving its citizens from the consequences of their own bad choices, including the choice of a college student to rack up large amounts of credit card debt. But there is also something to be said for industry self-restraint when it comes to marketing credit cards to teenagers and other members of society who may not fully understand the hole they are digging for themselves through the irresponsible use of credit.

Among the issues that our witnesses have been asked to address at today's hearing are the following:

- How the credit card industry sets interest rates and how these rates compare to the cost of other forms of consumer credit;
- How credit card companies disclose information to their customers, including changes in terms, teaser rates, and fees;
- The processing practices of the industry, including the posting of payments and the handling of customer complaints;
- Industry compliance with Federal consumer protection laws and the privacy requirements imposed by the Gramm-Leach-Bliley Act; and
- The response of the credit card industry to the events of September 11^{th}, including what efforts have been made to assist law enforcement in disrupting terrorist financing.

On this last point, I want to take this opportunity to commend those credit card issuers that have taken steps to provide relief - in the form of liberalized interest and fee policies and other accommodations - to those customers in the New York and Washington areas directly affected by the terrorist attacks on September 11^{th}. Rep. Chris Smith (R-NJ) and I hope that the industry will exhibit a similar spirit of forbearance when dealing with customers who have had their mail service disrupted by the recent anthrax cases along the East Coast.

Let me close by thanking all of our witnesses for agreeing to testify this morning on fairly short notice. We appreciate your attendance.

I now recognize the Ranking Member, Ms. Waters, for any opening statement she would like to make.

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

**"Giving Consumers Credit:
How the Credit Card Industry is Treating Consumers"
November 1, 2001**

I would like to thank Chairman Bachus for holding this hearing today.

Today Americans hold more credit cards and carry more credit debt than ever before. With the current sluggish economy and problems with the mail, this Subcommittee needs to examine the credit card industry to ensure that card holders are treated fairly. The industry has had problems in the past with the posting of payments, teaser rates and fees, and we must ensure that these practices do not resurface.

Of the 3 types of consumer credit available in the financial services industry, revolving bank card credit, accounts for only 10.4% of outstanding consumer credit an amount of slightly less than $585 billion. Installment loans (car loans for example) account for 13.9% or $782 billion, and home mortgages account for $4.3 trillion about 75.7% of all outstanding consumer credit. While it is the smallest segment of consumer credit, the credit card industry is a major provider of financial services and a multibillion-dollar industry.

Credit cards provide access to credit and payment conveniences. They provide a means of "cashless" transactions. They serve as an interest-free loan from the time of purchase until the payment is due. They provide customers with the ability to receive cash advances from automated teller machines. They provide customers with the ability to shop by telephone and on-line. They also provide an instant source of credit that is available without filling out forms or undergoing credit checks.

Unlike cash, a lost or stolen credit card can be replaced and there are liability limits for fraudulent or unauthorized charges. Credit cards also offer resources in case of emergencies, such as a large repair bill or airfare home during a family crisis.

However, there are definite disadvantages of credit cards, such as credit card debt may be more costly and difficult to repay than other forms of consumer credit. The convenience of credit cards may tempt some customers to live beyond their means. It is also noted that excessive credit card debt and late payments can impair a cardholder's credit rating and make it more difficult and costly to obtain credit in the future.

It seems that an appropriate purpose of this hearing is to assess how the industry is balancing competing advantages and disadvantages of its product and how it serves its customers.

I look forward to hearing the testimony of the witnesses.

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Statement of Rep. Christopher H. Smith (NJ-04)
before the Subcommittee on Financial Institutions and Consumer Credit

November 1, 2001

Protecting Consumers in the Age of Anthrax

Mr. Chairman, I greatly appreciate the opportunity to discuss legislation I have introduced, and which I hope will receive thorough analysis and favorable consideration by this committee. My proposal, HR 3175, the Late Fee Emergency Relief Act of 2001, would protect consumers from late payment penalties caused by mail delays resulting from acts of biological, chemical, or radiological terrorism.

In the event of a terrorist act that resulted in the disruption of mail, the legislation would require the Postmaster General to certify certain zip codes as being disrupted. This designation would be for a 30 day period. During the period of disruption, consumers would be given 30 additional days to make their payments or mortgages, and they would be protected from having to pay late fees, higher interest rates, or suffering from negative credit information being placed into their credit report. Persons whose principal residence is located in these affected zip codes would be afforded this modest protection.

Mr. Chairman, I drafted the legislation after learning that several of my constituents have already received late payment notices for bills they had mailed on time but had not been received due to the crisis at the Hamilton Regional Post Office. This post office is a critical hub for mail distribution for most of central New Jersey.

I believe that with the recent anthrax attacks on our postal system causing disruptions and delays in mail delivery, it is only reasonable that banks and creditors make reasonable accommodations for customers whose payments are delayed through no fault of their own. This legislation is carefully crafted to provide a mechanism for temporary relief for consumers. It will not allow people to escape their financial obligations, because the protection from late fees, higher interest rates, and negative credit information only lasts for 30 days.

Moreover, under HR 3175, the Postmaster General has the authority to continue to list affected zip codes if the mail disruptions are not ended within the 30 day window.

Mr. Chairman, I believe HR 3175 is a reasonable solution to a very real and pressing problem. I believe the financial services industry ought to work with consumers who are facing serious mail disruptions, and allow them leniency and extra time to make their payments.

Thank you.

Statement of

Dolores S. Smith

Director, Division of Consumer and Community Affairs

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

of the

U. S. House of Representatives

November 1, 2001

Thank you for inviting me to appear before this subcommittee. I am the director of the Federal Reserve Board's Division of Consumer and Community Affairs, which carries out the Board's responsibilities for administering a number of the consumer protection laws that make up the Consumer Credit Protection Act, including the Truth in Lending Act. As the subcommittee focuses on how the credit card industry is treating its customers, I would like first to provide some background information that might be useful to the subcommittee.

The Truth in Lending Act ("TILA") is the primary federal law that governs credit cards. It requires that consumers be provided with disclosures about the costs and terms of a credit card on or with a solicitation or application, at account opening before the first transaction, and with each periodic billing statement. TILA also requires creditors to credit accounts on the date the consumer's payment is received, it limits consumers' liability for unauthorized use of a credit card, and it provides procedures for resolving billing disputes. In addition to TILA, credit cards are also subject to various state laws that may regulate the terms of the accounts.

As part of the bank examination process, the Federal Reserve enforces the federal banking laws, including the Truth in Lending rules, with respect to the approximately 980 state-chartered banks that are members of the Federal Reserve System. Other regulators enforce these rules with respect to other institutions. The Board also investigates consumer complaints against state member banks, and forwards complaints involving other creditors to the appropriate enforcement agencies. In addition, the Federal Reserve's Division of Research and Statistics monitors certain trends in the credit card industry. I will share some observations with the committee based on the information that we have gathered in carrying out these functions.

Growth in the Credit Card Industry

Among the notable changes in consumer financial services over the past few decades has been the growth in the use of credit cards. Credit cards are used both as a means of payment and as a ready source of credit. Recent estimates suggest that in 2000, consumers used about 1.4 billion credit cards (or roughly 9 cards per holder) to purchase nearly 1.5 trillion dollars in goods and services in more than 20 billion individual transactions. It is estimated that at year-end 2000, consumers in the U.S. owed nearly $675 billion on general purpose credit cards.

In the Fair Credit and Charge Card Disclosure Act of 1988, the Congress directed the Federal Reserve Board to transmit annually to the Congress a report about the profitability of credit card operations of depository institutions, a copy of which is attached to my testimony. In 2000, credit card banks--those banks established primarily to issue and service credit card accounts--reported net earnings before taxes of about 3.14 percent of outstanding balances adjusted for credit card-backed securitization. This was slightly lower than in 1999. Recent earnings on credit card operations compare favorably with returns during the mid-1990s, but they remain below their high point attained in 1993.

The Federal Reserve has for many years sponsored surveys of consumers to gather information on their financial circumstances including their use of different forms of credit. The most recent Survey of Consumer Finances shows that in 1998 almost three-fourths of American families had one or more general purpose or retail store credit cards. General-purpose cards that have a revolving feature, often referred to as "bank-type" cards, show the most notable increase, rising from 16 percent of families in 1970 to 68 percent in 1998. Moreover, the survey shows that the holding of bank-type credit cards has become more widespread across all income groups over this period. For example, among families in the lower income quintiles, holdings of bank credit cards increased from two percent in 1970 to 28 percent in 1998.

Over the past several years, competition has led to substantial shifts in market shares among the industry's largest issuers of credit cards. Most of the larger issuers have grown by acquisition of credit card portfolios or by mergers. But several of the more rapidly growing firms have recently attracted market share by offering comparatively low-rate cards and attractive balance transfer programs. Others have gained market share through co-branding and offering rebates or annual fee waivers. The large number of direct mail solicitations of credit cards, some 3.5 billion in 2000, attests to the continuing desire of card issuers to expand and retain their cardholder base. The response rate on credit card solicitations in 2000 was estimated at .6 percent

Recent Trends in Credit Card Pricing

Over the past several years, pricing practices in the credit card market have changed significantly. Prior to the early 1990s, card issuers competed primarily by waiving annual fees and providing credit card program enhancements. Since then, however, interest-rate competition has played a much more prominent role. Many card issuers now offer a broad range of plans with differing rates depending on credit risk and consumer usage patterns. Risk-based pricing makes credit cards available to consumers with less-than-perfect credit histories, but also makes the credit more expensive for some consumers. Many issuers have also moved to variable-rate pricing, with rates that automatically adjust with changes in the market. A general decline in credit card interest rates from mid-1991 is the result of many factors, including a sharp drop in card issuers' cost of funds and greater competition on this aspect of credit card pricing. Today, credit card interest rates average about 14.6 percent. Apart from the information we have about interest rates, we have little systematic information about other aspects of credit card pricing.

Consumers' Attitudes Toward Credit Cards

The Federal Reserve has sponsored or participated in surveys of consumers' attitudes toward, and their understanding of, credit cards. The results of some of these surveys were published in an article in the Federal Reserve Bulletin for September 2000, a copy of which is attached.

Overall, consumers' opinions about the use of credit cards are somewhat more negative in 2000 than they were a generation ago, but those who actually hold bank-type cards are more favorable in their views than the general population. A survey in January 2000 reveals a divergence of views, and suggests that consumers who currently have negative views may have developed these in part based on their perceptions of <u>other</u> consumers' difficulties, rather than from the individual's own experiences. Ninety-one percent of the surveyed consumers with bank-type cards agreed that they were generally satisfied in their dealings with their own credit card companies. Ninety percent agreed that their credit card company treats them fairly, and 86 percent agreed that they could easily get a card from another company if they were not treated well. And yet, about 40 percent of those surveyed said that credit card use is "bad" and that consumers would be better off if there were no credit cards.

Consumers' views about their personal experiences with credit cards and their relations with their current card issuers are more favorable than their opinions of the relations of consumers in general. For example, 88 percent of surveyed consumers agreed with the statement that "credit card companies make too much credit available to most people." In contrast, about 90 percent of the holders of bank-type credit cards said that credit cards provide a useful service to consumers, and about 70 percent said that most people are satisfied in their dealings with card companies. About 60 percent disagreed with the statement that consumers would be better off without cards.

Consumer Complaints

As I noted earlier, the Board investigates consumer complaints against state member banks, and forwards complaints received about other creditors to the appropriate enforcement agency. The annual volume of complaints received by the Board has been increasing since 1997. Complaints about credit cards have similarly increased, rising by 58 percent over the same period.

In the year 2000, the Board received approximately 2,400 complaints about state member banks; a like number of complaints about other institutions were referred to other enforcement agencies. About 1,000 of the 2,400 complaints processed by the Board, or about 40 percent, were complaints about credit cards. These complaints are divided into a number of categories, but our review of the complaint data shows that about 60 percent of the credit card complaints fall into three categories: disputes about billing errors; concerns about penalty charges and other fees (such as late fees, over-the-limit fees, and annual fees); and disputes involving alleged errors in reporting consumers' payment history and the denial of requests for credit cards due to erroneous credit reports.

Information About Credit Terms

The Board has also participated in surveys that looked at consumers' knowledge of credit terms and their views concerning the availability of information about account terms. It appears that consumer awareness of APRs on bank-type credit cards has continued to rise, and was measured by the survey at 85 percent of bank-type card holders.

The survey also gathered information on consumers' perception about the ease of obtaining information about credit terms. About two-thirds of consumers in the 2000 survey who had bank-type credit cards said that obtaining information on credit terms is easy; only 7 percent of holders of bank-type cards believed that obtaining information on credit terms is "very difficult." The percentages of consumers holding these views about credit cards are similar to earlier surveys about credit generally. However, about 60 percent of the respondents did state that they found solicitations offering a low introductory rate to be confusing.

Disclosures for Credit Card Solicitations and Applications

The Fair Credit and Charge Card Disclosure Act of 1988 amended the Truth in Lending Act to require that the annual percentage rate (APR) for credit card purchases and certain other costs be disclosed in direct mail and other solicitations and applications to open credit and charge card accounts. Prior to that, consumers generally were not required to be provided with cost information until account opening. The purpose of the 1988 Act was to ensure that consumers receive key cost information about credit and charge cards early enough to have the opportunity to comparison shop. The act requires that the disclosures be given in the form of a table, with headings. The table is required to be in a prominent location on or with the solicitation or application.

Over the years, as the pricing of credit card programs has become more complex, the cost disclosures accompanying credit card solicitations have also become more complex. Multiple APRs may apply to a single program. For example, there may be a temporary introductory rate that applies to purchases and balance transfers, a fixed or variable rate that applies after the temporary introductory period, a separate rate for cash advances, and one or more "penalty rates" that apply if the consumer makes late payments.

As interest rates and other account features became more complex, and the cost disclosures became longer, some card issuers have chosen to use reduced type sizes instead of allocating additional space for the disclosures. In some cases it became difficult for consumers to use the disclosure table to readily identify key costs and terms for comparison shopping. In contrast, the promotional materials that accompany a credit card application or solicitation may highlight a low introductory APR in a large, easy to read type size. The rate that will apply after the introductory period may appear much less prominently in the promotional material, or it may appear only in the disclosure table. The disclosure table itself may be in a location that is less likely to capture the consumer's attention--for example, on the reverse side of an application or on the last page of a multi-page solicitation.

Last year, the Board made changes in the regulatory scheme to help ensure that consumers receive meaningful disclosures on a more consistent basis. The Board revised its rules for credit card solicitations and applications to make the required disclosure table more noticeable, simpler, and easier to use. These changes became effective on a mandatory basis on October 1, 2001, and consumers should now be seeing improved disclosures with the credit card offers they receive.

One of the key changes requires card issuers to disclose the regular APR for purchases in at least 18-point type, under a separate heading in the disclosure table, so that it is more prominent than any temporary introductory rate. The requirement that the disclosures be "clear and conspicuous" was also strengthened, to clarify that they must be readily noticeable. Disclosures automatically meet this standard if they are in at least 12-point type. Cash advance and balance transfer APRs must also be included in the table under the revised rules.

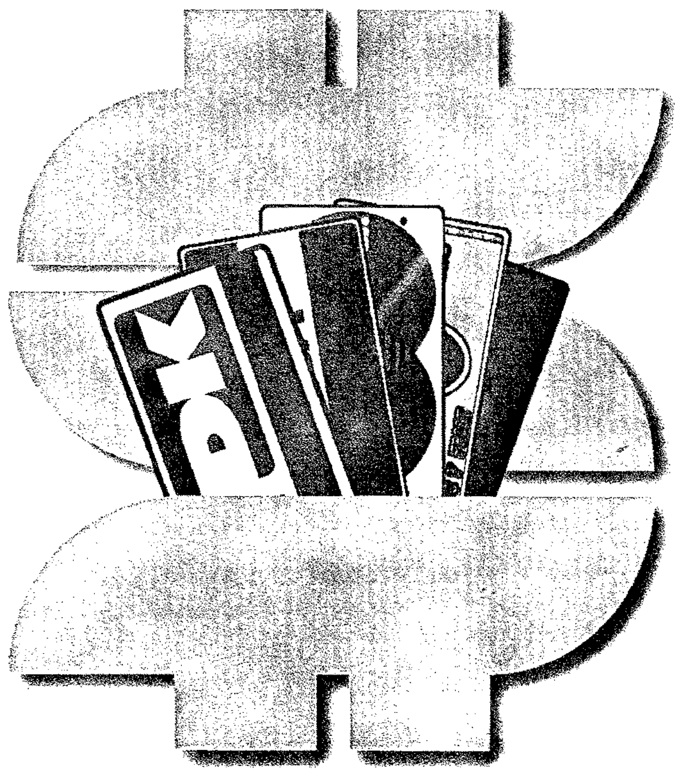
Although the Truth in Lending rules require that a cost disclosure table be included with credit card solicitations, the rules generally do not regulate the manner in which the account terms and features are presented in a card issuer's promotional materials. Often the promotional materials highlight a low introductory rate, while the higher rate that will apply when the introductory rate expires is more difficult to locate. Sometimes it appears only on the disclosure table as a separate insert. We note that the bankruptcy reform legislation currently pending in the Congress contains a provision to address this concern, and would require card issuers to list the permanent rate more prominently in promotional materials.

Enforcement

As I mentioned earlier, the Federal Reserve conducts compliance examinations of about 980 state member banks. In terms of size, 72 percent of the banks examined have total assets of $250 million or less. For the vast majority, credit card lending is not a significant activity. In fact, of the banks supervised by the Federal Reserve, only three banks are identified as having substantial credit card portfolios representing 50 percent or more of the banks' total loans.

In our examination of state member banks that are involved in credit card lending, we have not found any widespread practices that violate applicable laws or regulations. Violations have been found in only a small number of banks and, even in those cases, the violations generally have been isolated in scope.

SHOP



The Card You Pick Can Save You Money

1

Introduction

Smart consumers comparison shop for credit, whether they're looking for a mortgage, an auto loan, or a credit card. Comparison shopping is important because it could save you money.

When you're looking for a credit card, be sure to consider the costs and terms. They can make a difference in how much you pay for the privilege of borrowing. Compare them with the costs and terms of the cards you already have to find the plan that best fits your spending and repayment habits.

Key costs and terms to consider are the annual percentage rate (APR) for goods and services as well as for cash advances, the annual fee, and the grace period. Also compare cash-advance fees, late-payment charges, and over-the-limit fees.

Besides looking at these costs and terms, think about your typical bill-paying behavior. Do you pay your outstanding balance in full each month? Or do you usually carry over a balance? Matching the credit card plan to your needs could save money.

Credit Card Interest Rates

Credit card issuers offer variable-rate, fixed-rate, and tiered-rate plans. For variable-rate credit card plans, the interest rate is calculated according to a formula. Three of the most commonly used formulas are

Index + Margin = Variable rate
Index x Multiple = Variable rate
(Index + Margin) x Multiple = Variable rate

The most common indexes used by credit card issuers are the prime rate; the one-, three- and six-month Treasury bill rates; the federal funds rate; and the Federal Reserve discount rate. Most of the indexes are published in the money or business section of major newspapers. If the index rate used for your credit card changes, the rate on your card will, too.

The margin is a number of percentage points chosen by the credit card issuer. The card issuer also chooses the multiple.

The interest rate on a fixed-rate credit card plan, though not explicitly tied to changes in another interest rate, also can change over time. The card issuer must notify you before the "fixed" interest rate is changed.

A tiered interest rate means that different rates apply to different levels of the outstanding balance (for example, 16% on balances of $1–$500; 17% on balances above $500).

Some card issuers may have a policy that raises your interest rate if you make late payments. For example, if you make 2 late payments within 6 months, the card issuer may raise your interest rate from 18% APR to 24% APR. If such a penalty rate applies to your card, the issuer must include a notice in the solicitation materials.

Card issuers may also charge different rates for different types of transactions. For example, the card may carry one rate for purchases of goods and services, another rate for cash advances, and still another rate for balance transfers.

How Much Will You Pay?

The finance charge--that is, the dollar amount you will pay to use credit--depends on your outstanding balance and the periodic rate in your credit card plan:

Finance charge = Outstanding balance x Periodic rate

What Is the Outstanding Balance?

The outstanding balance can be calculated in several ways, and the method of calculation can make a big difference in the finance charge you will pay:

- Average daily balance method including new purchases. The balance is the sum of the outstanding balances for every day in the billing cycle (including new purchases and deducting payments and credits) divided by the number of days in the billing cycle.

- Average daily balance method excluding new purchases. The balance is the sum of the outstanding balances for every day in the billing cycle (excluding new purchases and deducting payments and credits) divided by the number of days in the billing cycle.
- Two-cycle average daily balance method including new purchases. The balance is the sum of the average daily balances for two consecutive billing cycles. One daily balance, that for the current billing cycle, is calculated by summing the outstanding balances for every day in the billing cycle (including new purchases and deducting payments and credits) and dividing that total by the number of days in the billing cycle. The other daily balance is that from the preceding billing cycle.
- Two-cycle average daily balance method excluding new purchases. The balance is the sum of the average daily balances for two consecutive billing cycles. One daily balance, that for the current billing cycle, is calculated by summing the outstanding balances for every day in the billing cycle (excluding new purchases and deducting payments and credits) and dividing that total by the number of days in the billing cycle. The other daily balance is that from the preceding billing cycle.
- Adjusted balance method. The balance is the outstanding balance at the beginning of the billing cycle minus payments and credits made during the billing cycle.
- Previous balance method. The balance is the outstanding balance at the beginning of the billing cycle.

Depending on the balance you carry and the timing of your purchases and payments, the average daily balance method excluding new purchases, the adjusted balance method, and the previous balance method tend to result in lower finance charges than the other balance-calculation methods.

What Is the Periodic Rate?

The periodic rate is the rate you are charged each billing period. Usually the periodic rate is the monthly interest rate, calculated by dividing the card's APR by 12. If your card has different rates for different types of transactions, then different periodic rates will apply to those balances. For example, if your card has a 12% APR on purchases, the periodic rate for purchases is 1%; and if your card has a 24% APR on cash advances, the periodic rate for cash advances is 2%.

The Right Card for You

While the outstanding balance and the periodic rate are important factors in choosing a credit card, they shouldn't be your only considerations. Other plan features may be more important to you, depending on how you use the card. For example, if you don't always pay your monthly bill in full, you'll probably be more interested in a card that carries a lower APR. On the other hand, if you always pay your monthly bill in full and card enhancements such as frequent flyer miles don't interest you, your best choice may be a card that has no annual fee and offers a longer grace period.

The grace period is the number days between the statement date and the due date during which you can pay your bill without incurring a finance charge. The card issuer may refer to the beginning or ending point of the grace period and tell you about any conditions that apply. For example, the issuer may say you have "25 days from the statement date, provided you have paid your previous balance in full by the due date." Keep in mind that the statement date is not the date on which you receive the bill; it is the date on which the issuer prepares the statement, which may be a week or two before you actually receive the bill in the mail.

How Much Could You Save?
The following example illustrates the annual savings you could achieve by switching to a credit card plan with a lower APR and no annual fee. The average monthly balance used in this simplified example is around the national average for consumers with credit card debt.

Terms	**Plan A**	**Plan B**
Average monthly balance	$2,500	$2,500
APR	x 18%	x 14%
Amount paid in finance charges annually	$450	$350
Annual fee	+ $20	+ $0
Total cost	$470	$350

By switching to a credit card plan with a lower APR and no annual fee, you could save $120 annually. Of course, this example assumes that the interest rate is applied to a constant balance of $2,500 and that you make all payments on time; if you paid down some of the balance each month, the amount paid in finance charges annually would be less. Also, if you make a payment late, you may incur additional fees that will increase your cost.

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Deciphering the Information in a Credit Card Solicitation or Application

Certain key pieces of information must be included in all solicitations or applications for credit cards. Look for a box similar to the one below for information about interest rates, fees, and other terms for the card you are considering.

1	Annual percentage rate (APR) for purchases	2.9% until 11/1/00 after that, **14.9%**
2	Other APRs	Cash-advance APR: 15.9%
		Balance-transfer APR: 15.9%
		Penalty rate: 23.9% See explanation below.*
3	Variable-rate information	Your APR for purchase transactions may vary. The rate is determined monthly by adding 5.9% to the Prime Rate**
4	Grace period for repayment of balances for purchases	25 days on average
5	Method of computing the balance for purchases	Average daily balance (excluding new purchases)
6	Annual fees	None
7	Minimum finance charge	$.50

8 Transaction fee for cash advances: 3% of the amount advanced

9 Balance-transfer fee: 3% of the amount transferred

10 Late-payment fee: $25

11 Over-the-credit-limit fee: $25

*Explanation of penalty. If your payment arrives more than ten days late two times within a six-month period, the penalty rate will apply.

**The Prime Rate used to determine your APR is the rate published in the Wall Street Journal on the 10th day of the prior month.

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① *APR for purchases*
The interest rate you will pay, on an annual basis, if you carry over balances on purchases from one billing cycle to the next. If the card has a temporary introductory rate, the rate that applies after the temporary rate expires is also stated.

② *Other APRs*
The interest rates you will pay, on an annual basis, if you get a cash advance on your credit card, if you transfer a balance from another credit card, or if the card issuer applies penalty rates. (More information on the penalty rate may be included outside the disclosure box--for example, in a footnote.)

③ *Variable-rate information*
If the card has a variable rate instead of a fixed rate, this section will tell you how the variable rate is determined. (More information may be included outside the disclosure box--for example, in a footnote.)

④ *Grace period for repayment of balances for purchases*
The number of days you have to pay your bill in full without triggering any finance charges. With most plans, the grace period applies only to purchases; cash advances and balance transfers may start accruing interest immediately.

⑤ *Method of computing the balance for purchases*
The method that will be used to calculate your outstanding balance if you carry over a balance and will pay a finance charge.

⑥ *Annual fees*
The annual fee (or other periodic fee) the issuer charges for you to have the card. You may have to pay this fee even if you never use the card.

⑦ *Minimum finance charge*
Any minimum or fixed finance charge that could be imposed during a billing cycle. A minimum finance charge usually applies only when a finance charge is imposed, that is, when you carry over a balance.

(8) *Transaction fee for cash advances*
Any charge imposed when you use the card for a cash advance. If the card charges transaction fees for purchases, these fees will also be stated here.

(9) *Balance-transfer fee*
A fee for transferring balances from another card to this card, if any.

(10) *Late-payment fee*
The fee imposed if your payment is late, if any.

(11) *Over-the-credit-limit fee*
The fee imposed if your charges exceed the credit limit set for your card, if any.

Credit Card Shopper's Checklist

Here are some tips for shopping for a credit card or evaluating the cards you already have.

1. Make a list of features that best fit your needs, and rank them according to how you plan to use the card.

2. Call the issuers of the cards that seem to match your needs to verify the publicized information. Ask if they have any other plans available.

3. If you are currently a cardholder and have a good credit rating, ask the issuer of your card to lower your current rate or to reduce or waive your annual fee. Negotiate.

4. Review the following information about the plans:

Availability
Is the card accepted nationally? Regionally? Only in one state? Only in a specific store?

Interest rate pricing
Is the interest rate fixed? Variable? Tiered? If the rate is variable, what is the index? The margin? The multiple?

APR
What is the APR for purchases? For cash advances? For balance transfers? Is there a penalty rate if you make late payments?

Finance charge
What method for determining the outstanding balance is used to calculate the finance charge?

Annual fee
What is the annual fee, if any?

Grace period
What is the grace period for purchases? (Grace periods usually do not apply to cash advances, which begin accruing interest from the day of the transaction.)

Other features
Does the plan offer enhancements that are attractive to you, such as cash rebates, purchase protections, warranties or guarantees, travel accident or automobile rental insurance, discounts on goods and services purchased, and incentives for use, such as frequent flyer miles? Are these features available at no extra cost?

Cracking the Credit Code
Glossary of Credit Terms

Annual fee
A flat, yearly charge similar to a membership fee

Annual percentage rate (APR)
A measure of the cost of credit expressed as a yearly rate. Many credit card plans charge different APRs for credit used in different ways--for

example, one APR for purchases, another for cash advances, and still another for balance transfers. Some plans may increase the APR if a payment is late.

Cash-advance fee
A fee charged if you obtain a cash advance. This fee is in addition to the interest rate charged on the amount of the advance.

Finance charge
The dollar amount you pay to use credit. Besides interest costs, the finance charge may include other charges such as cash-advance fees.

Grace period
A period of time, often about 25 days, during which you can pay your credit card bill without incurring a finance charge. Under nearly all credit card plans, the grace period applies only if you pay your balance in full each month. It does not apply if you carry a balance forward. Also, the grace period usually does not apply to cash advances, which may begin accruing interest from the day of the transaction.

Interest rate
A measure of the cost of credit, expressed as a percent. For variable-rate credit card plans, the interest rate is explicitly tied to another interest rate, such as the prime rate or the Treasury bill rate. If the other rate changes, the rate on you card will, too. The interest rate on fixed-rate credit card plans, though not explicitly tied to changes in other interest rates, can also change over time. The card issuer must notify you before the "fixed" interest rate is changed. A tiered interest rate means that different rates apply to different levels of the outstanding balance (for example, 16% on balances of $1–$500; 17% on balances above $500).

Late-payment charge
A charge imposed when your payment is late. If your payment arrives after the grace period, you may be charged both a finance charge (the interest on your outstanding balance) and a late-payment charge. Some

card issuers may also impose a penalty rate if you have more than one late payment within several months.

Over-the-limit fee
A fee imposed when your charges exceed the credit limit set on your card.

Penalty rate
The rate that applies under specific circumstances set out by the card issuer. For example, if you make 2 late payments within 6 months, a card issuer may have a policy of raising the interest rate.

Periodic rate
The rate you are charged each billing period. For most credit card plans, the periodic rate is a monthly rate, calculated by dividing the APR by 12. For example, a credit card with an 18% APR has a monthly periodic rate of 1.5%.

For more information:

You can find listings of credit card plans, rates, and terms on the Internet, in personal finance magazines, and in newspapers.

The following federal agencies are responsible for enforcing the federal Truth in Lending Act, the law that governs disclosure of terms for credit cards. Questions concerning compliance by a particular financial institution or credit card issuer should be directed to the institution's regulatory agency.

Federal Reserve Board
Division of Consumer and Community Affairs
Mail Stop 801
Washington, DC 20551
(202) 452-3693
(*regulates state banks that are members of the Federal Reserve System*)

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Comptroller of the Currency
Office of the Ombudsman
Customer Assistance Unit
1301 McKinney Street, Suite 3710
Houston, TX 77010
1 (800) 613-6743
(*regulates banks with "national" in the name or "N.A." after the name*)

Federal Deposit Insurance Corporation
Compliance and Consumer Affairs
550 17th Street, NW
Washington, DC 20429
(202) 942-3100 or 1 (877) 275-3342
(*regulates state-chartered banks that are not members of the Federal Reserve System*)

Office of Thrift Supervision
Consumer Programs
1700 G Street, NW
Washington, DC 20552
(202) 906-6237 or 1 (800) 842-6929
(*regulates federal savings and loan associations and federal savings banks*)

National Credit Union Administration
Office of Public and Congressional Affairs
1775 Duke Street
Alexandria, VA 22314-3428
(703) 518-6330
(*regulates federally chartered credit unions*)

Federal Trade Commission
Consumer Response Center
6th and Pennsylvania, NW
Washington, DC 20580
877-FTC-HELP - toll free (877-382-4357)
(*regulates finance companies, stores, auto dealers, mortgage companies, and credit bureaus*)

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FRB3-2000-801

Credit Cards: Use and Consumer Attitudes, 1970–2000

Thomas A. Durkin, of the Board's Division of Research and Statistics, prepared this article. Nicole Price provided research assistance.

A notable change in consumer financial services over the past few decades has been the growth of the use of credit cards, both for payments and as sources of revolving credit. From modest origins in the 1950s as a convenient way for the relatively well-to-do to settle restaurant and department store purchases without carrying cash, credit cards have become a ubiquitous financial product held by households in all economic strata.

In modern commerce, credit cards (along with debit cards) serve as a payment device in lieu of cash or checks for millions of routine purchases as well as for many transactions that would otherwise be inconvenient, or perhaps impossible (for example, making retail purchases by telephone or over the Internet). Credit cards have also become the primary source of unsecured open-end revolving credit, and they have largely replaced the installment-purchase plans that were important to the sales volume at many retail stores in earlier decades.

Along with most major societal changes come questions about whether the trend is beneficial or detrimental (or somewhere in between), and the rise of plastic cards for payments and open-end credit is no exception. Credit cards certainly are widely used and accepted by the public. But they have also raised concerns in two areas: (1) whether consumers fully understand the costs and implications of using credit cards (the consumer information–consumer understanding concern) and (2) whether credit cards have encouraged widespread overindebtedness, particularly among those least able to pay (the indebtedness–financial distress concern). The two issues are related, because one result of lack of understanding may be overindebtedness. Both issues remain prominent in public discourse, as debt and personal bankruptcy levels have increased over the decades and media reports of confused consumers have multiplied.

Although one can usually find anecdotes to illustrate a point—consumers who are unaware of the costs of credit cards, for instance, or consumers who overspend because of the wide availability of credit—such examples can never lead to a definitive understanding of issues having broad social or economic impact. Statistically representative surveys can contribute to a more complete understanding of consumers' experiences. Taken together, such surveys can serve as a status report on the use of credit cards some fifty years after their introduction. This article brings to the discussion some survey evidence on the use of credit cards in the United States. It begins with an examination of long-term trends in consumer indebtedness, with attention to the growth of card-based credit. It then moves to an exploration of the consumer information–consumer understanding issue, with emphasis on consumers' attitudes toward credit cards and their knowledge of costs.

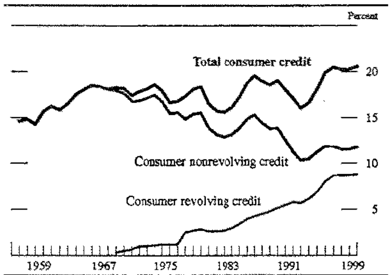
CREDIT CARDS AND INDEBTEDNESS

The Federal Reserve Board collects data on amounts of consumer credit outstanding, including amounts of revolving consumer credit, most of which is generated by credit cards.[1] Total (nonmortgage) consumer credit outstanding increased from $119 billion at year-end 1968 to $1,456 billion in June 2000 (in current dollars, not seasonally adjusted), while the revolving component grew from $2 billion to about $626 billion over the same period. Because population, income, employment, prices, and nearly every other economic indicator also rose over the period, the growth of consumer credit is often put in perspective by comparing it with the growth of consumers' income.

Total (nonmortgage) consumer credit outstanding (revolving and nonrevolving forms combined) has

1. Consumer credit covers most short- and intermediate-term credit extended to individuals. It includes revolving credit (credit card credit and balances outstanding on unsecured revolving lines of credit) and nonrevolving credit (such as secured and unsecured credit for automobiles, mobile homes, trailers, durable goods, vacations, and other purposes). Consumer credit excludes loans secured by real estate (such as mortgage loans, home equity loans, and home equity lines of credit).

1. Consumer credit outstanding as a proportion of disposable personal income, 1956–99



SOURCE. Federal Reserve Board and Bureau of Economic Analysis.

grown at approximately the same pace as disposable personal income over the past generation, although with noticeably more cyclicality. Since the mid-1960s, total consumer credit outstanding relative to this measure of income has fluctuated in a relatively narrow range of about 16 percent to 17 percent during or following recession periods to about 18 percent to 21 percent near business-cycle highpoints (chart 1).

The revolving component of consumer credit has increased relative to income over the most recent three decades, and the nonrevolving component has decreased relative to income. Thus, the revolving component's share has been growing relative to the nonrevolving component's share, reflecting consumer preference and technological change; many consumers seem to like the convenience associated with prearranged lines of credit, and technological developments have made it much easier for creditors to offer this data-intensive product. A substantial portion of the new revolving credit probably has merely replaced credit generated by the installment-purchase plans that were common at appliance, furniture, and other durable goods stores in the past. And some of the new credit is in the form of "convenience credit" on credit cards—amounts that will be paid in full upon receipt of the monthly statement. (Installment-purchase plans have no equivalent "convenience" component.)

Card Holding among Families

Dollar amounts of credit card credit outstanding can be estimated from information provided by creditors, but only surveys of consumers can provide information about the users and uses of credit cards. For this reason, each Survey of Consumer Finances since 1970 has included questions on the holding and use of credit cards (the 1967 and 1968 surveys also included a few questions about credit cards).[2]

These surveys show that in 1998 almost three-fourths of American families had one or more credit cards, up from about one-half of a smaller population in 1970 (table 1). Among credit cards, the general-purpose cards that have a revolving feature, referred to in this article as "bank-type" credit cards, show the most notable increase over the period.[3] In the early 1970s, limited-use cards issued by retail firms, usable only in the firm's stores, were the most commonly held type of credit card; bank-type cards were much less common. By 1995, however, the holding of bank-type cards was more common than the holding of retail store cards.

The holding of bank-type credit cards has continued to grow in recent years, whereas the holding of retail store cards peaked about a decade ago and has fallen off since then. In fact, bank-type cards issued under the Visa and MasterCard brands are so widely held and used today that it is difficult to imagine that they were not especially common only three decades ago. Known at that time as BankAmericard and Master Charge, respectively, and issued only by commercial banking organizations, they were a new product in the mid-1960s and by 1970 together had reached only about one-sixth of families; the other major bank-type cards widely available today, Discover and Optima, were not even on the drawing boards at that time. By 1998, bank-type cards (including Discover and Optima) were in the hands of about two-thirds of families. In three decades, the general-purpose card with a revolving feature has become the most widely held credit device.

Consumers use credit cards for two main purposes as a substitute for cash and checks when making purchases and as a source of revolving credit. In 1970, just over one-fifth of all families owed a balance on a credit card after making their most recent card payment (table 1). By 1998, the fraction was just over two-fifths. Most of the increase was due to the

2. The Survey of Consumer Finances series is sponsored by the Federal Reserve Board, sometimes jointly with other agencies. The 1977 survey in this series was titled the 1977 Consumer Credit Survey but is referred to in this article as the 1977 Survey of Consumer Finances because it is part of the same series. For a general description of results from recent surveys, see Arthur B. Kennickell, Martha Starr-McCluer, and Brian J. Surette, "Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 86 (January 2000), pp. 1–29.

3. "Travel and entertainment" cards such as American Express and Diners Club are not included here as "bank-type" cards because they do not offer a revolving feature.

1. Prevalence of credit cards among U.S. families, selected years, 1970–98
Percent

Item	1970	1977	1983	1989	1995	1998
Have a card						
Any card[1]	51	63	65	70	74	73
Retail store card	45[2]	54	58	61	58	50
Bank-type card[3]	16	38	43	56	66	68
Have a card with a balance after the most recent payment						
Any card[1]	22	34	37	40	44	42
Retail store card	15	25	29	28	24	19
Bank-type card[3]	6	16	22	29	37	37
MEMO						
Families having any card with an outstanding balance after the most recent payment as a proportion of all families having cards	44	56	57	57	59	58
Families having a bank-type card with an outstanding balance after the most recent payment as a proportion of all families having bank-type cards	37	44	51	52	56	55
Proportion of families having a bank-type card who hardly ever pay revolving card balances in full	...	18	25	26	28	27

NOTE. In 1970, families were asked about *using* credit cards; in all other years, they were asked about *having* cards.

1. Includes cards issued by banks, gasoline companies, retail stores and chains, travel and entertainment card companies (for example, American Express and Diners Club), and miscellaneous issuers (for example, car rental and airline companies).

2. Data are for 1971.

3. A bank-type card is a general-purpose credit card with a revolving feature; includes BankAmericard, Choice, Discover, MasterCard, Master Charge, Optima, and Visa, depending on year.

... Not available.

SOURCE. Surveys of Consumer Finances.

growing popularity of bank-type cards as devices for generating revolving credit. In 1970, only 6 percent of families had a bank-type card with an outstanding balance after their most recent payment. The proportion rose steadily until 1995 and then leveled off at 37 percent. In contrast, the proportion of families reporting an outstanding balance on a retail store card peaked in 1983 at 29 percent, and in 1998, at 19 percent, it was only a bit higher than the 15 percent recorded in 1970. Of those families that had bank-type cards, 37 percent had revolved a balance in the month before the 1970 survey, compared with 55 percent in the month before the 1998 survey. In 1977, 18 percent of holders of bank-type cards reported that they hardly ever paid their revolving accounts in full, a proportion that rose to 25 percent in 1983 and has remained at about that level since then.

Distribution of Bank-Type Credit Cards

Data from the Surveys of Consumer Finances indicate that the holding of general-purpose credit cards with a revolving feature has become more widespread among households at all income levels. For families in the lowest income group, 2 percent had a bank-type credit card in 1970, compared with 28 percent in 1998 (table 2). For those in the highest income group, the holding of bank-type cards almost tripled between 1970 and 1995—from 33 percent to 95 percent.

For each income group, the percentage of cardholders carrying a balance on bank-type cards also increased over the three decades, as did the mean and median revolving credit balances (in constant dollars). Despite some shifts within the period, the shares of total revolving balances on these cards accounted for by each income group has not changed dramatically over the decades, perhaps contrary to popular impressions. For example, despite a sharp increase in card holding by the lowest income group, the group's share of total revolving debt on bank-type cards rose only to 5 percent in 1998, up from 2 percent in 1970 but still not a large proportion of the total. The highest income group accounted for 30 percent of revolving debt on bank-type cards in 1970, a share that over the three decades fell off only a bit, to 29 percent in 1998.

The expanded availability of card-based credit, especially to lower-income consumers, has raised concerns that issuers have taken on more credit risk and that instances of financial distress may increase sharply at some point. Data on the proportion of dollars of revolving credit delinquent thirty days or more, available from Call Reports submitted by commercial banks since 1991, indicate an upward trend from 1994 to 1996 and a leveling after that (chart 2). This pattern is similar to that for delinquencies on closed-end (nonrevolving) consumer credit extended by banks, much of which is secured credit associated with the purchase of automobiles. Data on the proportion of consumers (rather than dollars) delinquent, assembled by the Credit Research Center (Georgetown University) from a random sample of consumer credit reports maintained by a national credit reporting agency, show that at year-end 1999, 3.4 percent

2. Prevalence of bank-type credit cards and outstanding balance amounts, by family income quintiles, selected years, 1970–98

Percent except as noted

Income quintile	1970	1977	1983	1989	1995	1998
Lowest						
Have a card	2	11	11	17	28	28
Carrying a balance	27	40	40	43	57	59
Mean balance (dollars)	896	731	1,147	784	2,386	2,240
Median balance (dollars)	336	538	818	592	995	700
Share of total revolving balance	2	4	4	2	6	5
Second lowest						
Have a card	9	22	27	36	54	58
Carrying a balance	39	42	49	46	57	58
Mean balance (dollars)	659	1,055	906	1,712	2,622	3,028
Median balance (dollars)	504	565	655	1,315	1,605	1,400
Share of total revolving balance	9	13	8	8	14	13
Middle						
Have a card	14	36	41	62	71	72
Carrying a balance	47	45	58	56	58	58
Mean balance (dollars)	820	883	1,161	2,159	2,952	4,129
Median balance (dollars)	630	672	736	1,262	1,605	1,900
Share of total revolving balance	22	19	19	21	21	23
Second highest						
Have a card	22	51	57	76	83	86
Carrying a balance	39	52	56	62	60	60
Mean balance (dollars)	1,010	846	1,259	2,212	2,687	4,334
Median balance (dollars)	840	753	818	1,183	1,605	2,000
Share of total revolving balance	37	30	28	30	23	29
Highest						
Have a card	33	69	79	89	95	95
Carrying a balance	30	39	47	46	50	45
Mean balance (dollars)	761	898	1,531	3,417	4,460	5,232
Median balance (dollars)	630	672	916	2,630	2,246	2,500
Share of total revolving balance	30	33	40	40	36	29
All families						
Have a card	16	38	43	56	66	68
Carrying a balance	37	44	51	52	56	55
Mean balance (dollars)	839	889	1,282	2,404	3,160	4,073
Median balance (dollars)	630	672	818	1,315	1,605	1,900
Share of total revolving balance	100	100	100	100	100	100

NOTE. In 1970, families were asked about *using* cards; in all other years, they were asked about *having* cards. Proportions that "have a card" are percentages of families; proportions "carrying a balance" are percentages of holders of bank-type cards with an outstanding balance after the most recent payment. Mean and median balances are for cardholders with outstanding balances after the most recent payment and are in 1998 dollars, adjusted using the Consumer Price Index for All Urban Consumers, all items. Shares may not sum to 100 percent because of rounding.

SOURCE. Surveys of Consumer Finances.

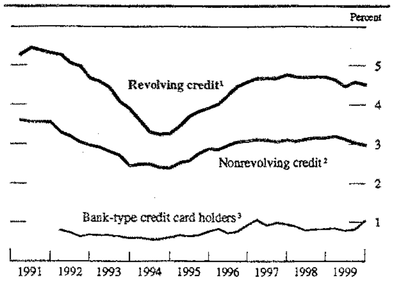
of consumers were thirty days delinquent on at least one bank-type card account (not shown in chart). This source also shows that more serious delinquency (overdue ninety days or more) has remained at or slightly below 1 percent of holders of active bank-type card accounts over the past decade.[4]

CONSUMER INFORMATION AND CONSUMER UNDERSTANDING

Beginning with the Truth in Lending Act (enacted in 1968 as Title I of the Consumer Credit Protection Act, effective July 1, 1969), much federal legislation regulating consumer credit has concerned either mandatory fairness procedures (the Equal Credit Opportunity Act, for example) or mandatory disclosures (the Truth in Lending Act, for example). The disclosure requirements have in large part been intended to help prevent or mitigate overextension and other difficulties resulting from a lack of understanding of credit terms and the consequences of using credit. General-purpose household surveys can help in assessing the effects of these laws. Unfortunately, the specifics of many individual consumer's credit-related difficulties do not lend themselves to such broad-based surveys. Surveying currently delinquent debtors, for example, is difficult with a broad survey because delinquency is relatively rare; large numbers of interviews must be completed to yield enough cases to analyze an uncommon phenomenon with precision. General-purpose surveys can, however, characterize consumers' overall impressions of their card-using experiences and their views on conditions in the marketplace, including the availability of information.

4. See Credit Research Center (McDonough School of Business, Georgetown University, Washington, D.C.), *Monthly Statements*, various issues.

2. Consumer credit delinquency rates, 1991–99



1. Percentage of revolving credit (dollars) delinquent thirty days or more.
2. Percentage of nonrevolving credit (dollars) delinquent thirty days or more.
3. Percentage of holders of active bank-type credit card accounts delinquent ninety days or more on one or more bank-type cards.

SOURCE. For revolving and nonrevolving credit, Call Reports submitted by commercial banks. For bank-type credit card holders, Credit Research Center, *Monthly Statements*, various issues (based on data from a sample of consumer credit reports).

Consumers' Attitudes toward Credit Cards

To explore consumers' attitudes toward and understanding of credit cards, as well as to gather information about card use, the Credit Research Center in January 2000 sponsored interviews of nearly 500 households representative of households in the forty-eight contiguous states. Interviewing was done by the Survey Research Center of the University of Michigan as part of its monthly Surveys of Consumers.

General Attitudes

Respondents—both those who used credit cards and those who did not—were first asked their broad feelings about credit cards. So that attitude changes could be tracked over time, the question was identical to the question asked in nationwide Surveys of Consumer Finances in 1970 and again in 1977: "People have different opinions about credit cards. Overall, would you say that using credit cards is a good thing or a bad thing?"

Overall opinions about credit cards are somewhat more negative and polarized in 2000 than they were a generation ago, especially among holders of bank-type cards (table 3). Opinions among all families that credit card use is "good" register a bit higher in 2000 (33 percent) than in 1970 (28 percent) but a bit lower than in 1977 (39 percent). The view that card use is "bad" is stronger in 2000 than in either of the earlier years.

In all three surveys, views among holders of bank-type cards were more favorable than those among the population generally. Nonetheless, unfavorable views among cardholders have increased over the decades; negative attitudes among cardholders are much more common in 2000 (42 percent) than they were in 1977 (14 percent). This finding is interesting because card use is also much greater in 2000. In 2000, holders of bank-type cards are about equally divided in their opinions that credit card use is good or bad, much different from 1977, when a considerably larger proportion had a favorable opinion.[5]

Consumers' opinions about credit cards also vary depending on their use of and experience with cards. Less enthusiastic viewpoints are somewhat more common among those who use credit cards as credit devices rather than primarily as substitutes for cash

5. Interestingly, contrary opinions about consumer credit, even from the same person, apparently have been around much longer than these surveys. Referring to the paradox of dichotomous views as the "Victorian money-management ethic," a cultural historian recently pointed out that the simultaneous belief that credit is good but debt is bad is actually at least as old as American history. See Lendol Calder, *Financing the American Dream: A Cultural History of Consumer Credit* (Princeton, N.J.: Princeton University Press, 1999).

3. Opinions about the use of credit cards, selected years
Percent

Opinion	1970		1977		2000	
	All families	Bank-type card users	All families	Bank-type card holders	All families	Bank-type card holders
Good	28	45	39	54	33	42
Good, with qualification	13	17	19	20	10	9
Both good and bad	12	14	11	8	6	5
Bad, with qualification	4	4	4	3	1	1
Bad	43	20	27	14	51	42
Total	**100**	**100**	**100**	**100**	**100**	**100**

NOTE. Components may not sum to 100 because of rounding.

SOURCE. For 1970 and 1977, Surveys of Consumer Finances; for 2000, Surveys of Consumers.

or checks. Specifically, cards are viewed less positively by those who have three or more cards, have an outstanding balance of more than $1,500, have transferred a balance between cards, hardly ever pay their outstanding balance in full, hardly ever pay more than the monthly minimum, or have received a collection call.

Prevalence of negative attitudes toward using credit cards among holders of bank-type credit cards, 2000

Cardholder group	Percent believing that using credit cards is bad
All holders of bank-type cards	42
Have a new card account in the past year	47
Have three or more cards	49
Have an outstanding balance greater than $1,500 after the most recent payment	57
Have transferred a balance to another account in the past year[1]	60
Hardly ever pay outstanding balance in full	59
Hardly ever pay more than the minimum[1]	63
Have paid a late fee in the past year	47
Have received a collection call in the past year[1]	62
Family's annual income is $40,000 to $74,999	49
Respondent has high school diploma or some college, but not a degree	46
Respondent is 35 to 54 years old	48

1. Weighted sample size less than fifty.
SOURCE. Surveys of Consumers.

Conversely, those who have fewer cards, have no balance or a low balance outstanding, generally pay more than the minimum, or have not received a collection call have more favorable views (not shown in the table). Demographic measures also appear to be related to attitudes toward credit cards, but the relationship is not as strong as that associated with the variables related to the use of cards.

Attitudes toward Card Features, Card Issuers, and Other Users

To examine why card users might have the general attitudes about credit cards that they do, the 2000 survey also asked questions about specific features of credit cards and about card issuers and users. The questions took the form of statements with which respondents could agree or disagree. Although data from earlier years are not available for comparison, responses to these questions reveal an interesting divergence of views that might help explain why overall attitudes have deteriorated. The responses suggest that the current negativity may have arisen in part from an individual's perceptions of *other* consumers' difficulties rather than from the individual's own experiences. Without data from earlier periods and questions designed specifically to address this hypothesis, one cannot be certain, but from the 2000 survey results it seems likely that as card use has become more common, negative opinions about card use may have increased as a result of perceptions about "the other guy." Views about personal experiences with credit cards, in contrast, are much more positive.

Consumers in 2000 seem to be concerned about specific practices of credit card issuers. Most holders of bank-type credit cards (more than 80 percent) believe that the annual percentage rates charged on outstanding balances are too high (table 4). They also express concern over privacy practices. In contrast, relatively few express concern about billing accuracy.

Consumers' feelings about experiences with credit cards in general are even more negative than their feelings about specific practices.[6] Holders of bank-type credit cards in 2000 believe that too much credit is available, that consumers are confused about some practices, and that credit users have difficulty getting out of debt. Somewhat over half said that issuers should not be allowed to market cards to college students. Moreover, they appear to believe that consumers bring on themselves many of the problems associated with credit cards: Ninety percent agree to some extent that overspending is the fault of consumers, not of card issuers.

Survey evidence does not suggest that increasingly negative views of credit cards have arisen from adverse personal experiences. Rather, consumers' opinions about *their own* relations with their current card issuers are much more favorable than their opinions about the relations of consumers in general. Approximately nine in ten holders of bank-type credit cards said that they are satisfied with their dealings with card companies, that their card companies treat them fairly, and that it is easy to get another card if they are not treated fairly. Almost seven in ten trust that their own card companies would keep their personal information confidential, substantially more than the proportion believing that card companies in general show enough concern about protecting privacy (just under five in ten). Cardholders' opinions about their own experiences are almost the reverse of their views about consumers' experiences in general, suggesting considerable concern over the behavior of others and possibly a belief that "I can handle credit cards, but other people cannot."

Despite expressed concerns about some practices and experiences, consumers appear to be satisfied

6. Survey interviewers did not offer the statements in the order given in table 4; the table groups topically similar questions for analytical purposes.

4. Attitudes of holders of bank-type credit cards toward credit cards and card issuers, 2000

Percent

Attitude	Strongly agree	Agree somewhat	Disagree somewhat	Strongly disagree
Specific practices of card issuers				
The interest rates charged on credit cards are reasonable	3	16	26	55
Credit card companies show enough concern for protecting consumers' privacy	17	30	21	31
Credit card billing statements are accurate	54	39	5	2
Card issuers and consumers in general				
Credit card companies make too much credit available to most people	68	20	9	4
Sending solicitations that offer low rates but only for a short time probably misleads a lot of people	79	14	4	3
Credit card companies make it hard for people to get out of debt	55	27	10	9
Credit card companies should not be allowed to issue credit cards to college students	30	25	23	22
Overspending is the fault of consumers, not the credit card companies	63	27	6	4
Card issuers and me				
I am generally satisfied in my dealings with my credit card companies	51	40	6	4
My credit card companies treat me fairly	54	36	6	4
It is easy to get a credit card from another company if I am not treated well	63	23	10	4
I trust that my credit card companies will keep my personal spending information confidential	31	38	16	15
General satisfaction or dissatisfaction				
Credit card companies provide a useful service to consumers	44	48	6	2
Most people are satisfied in their dealings with credit card companies	15	54	20	11
Consumers would be better off if there were no credit cards	15	26	30	29
Information availability				
Information on the statement about how long it would take to pay off the balance if I make only the minimum payment would be very helpful to me	65	24	7	4
Mailings and other ads that offer a low rate at first followed by a higher rate are confusing to me	36	25	15	24
MEMO: General satisfaction or dissatisfaction with closed-end creditors and lenders in 1977				
They provide a useful service to consumers	42	51	6	1
Most people are satisfied in their dealings with them	17	60	18	5
It would be a good thing for consumers if they were not around	6	21	36	38

NOTE. Components may not sum to 100 because of rounding.

SOURCE. Surveys of Consumers; memo items, 1977 Survey of Consumer Finances.

with the credit card market in general. Approximately nine in ten holders of bank-type credit cards said that credit cards provide a useful service to consumers, and about seven in ten said that most people are satisfied in their dealings with card companies. About six in ten disagreed that consumers would be better off without cards. These results are similar to those from a 1977 survey of users of nonrevolving credit (memo items in table 4). It seems that credit and creditors are not viewed completely favorably, even by users of the service, but that most users are favorably inclined.

Many holders of bank-type cards in 2000 said that it would be helpful to include on their billing statement information about the length of time it would take to pay off the balance if only the minimum payment were made each month. Exactness in such a calculation assumes, of course, that the consumer does not use the card during the repayment period and that the balance declines on schedule. If the balance were to fluctuate substantially, the calculation would be difficult or impossible, and most likely meaningless (discussed further later). Survey respondents probably did not consider the implications and complexity of the calculations but were simply acknowledging a desire for a practical measure of the burden they are incurring. Many respondents also reported that "teaser rates" are confusing. They could, of course, avoid teaser rates altogether by ignoring the mailings that promote them; consequently, this survey finding may reflect concerns among consumers that card issuers have complicated promotions sufficiently that it is difficult to understand and accept advantageous offers when they are made.

What emerges from these responses to opinion questioning, in sum, is a multifaceted set of attitudes about credit cards. Multifaceted opinions are not especially surprising, given that consumers overall seem to think that credit cards are both good and bad. They believe that finance percentage rates on outstanding balances are too high, are suspicious of how personal information is used, and have relatively little confidence in other individuals who use credit cards. When they imagine "the other guy" in contact with card issuers, whose behavior is already suspect, they imagine possibly negative consequences, for example, excessive credit use. When the focus shifts to more-personal experience, however, they view the outcome much more favorably, suggesting that actual problems with credit cards are not nearly as widespread as consumers imagine them to be when they think about the population of largely unknown "others." On balance, holders of bank-type credit cards in 2000 believe that credit cards are useful and that consumers are better off with them than without them—despite concerns over the inability of "other (unknown) consumers" to exercise self-discipline and avoid overuse; these opinions seem to mirror earlier views about installment credit. Finally, consumers believe that additional, and less-confusing, information about payments and rates would be useful.

Information about Credit Terms

In addition to attitudes, the January 2000 Survey of Consumers specifically looked at consumers' knowledge of credit terms and their views concerning the availability of information about terms.

Assessing consumers' knowledge of credit terms and their use of that knowledge is not a straightforward matter. One question is which term or terms to focus on. A second question is how, in an interview survey, to determine the accuracy of the consumer's knowledge. Since implementation of the Truth in Lending Act, the annual percentage rate (APR) has been considered the most important term concerning the price of credit to be disclosed by creditors, and consequently it has been the credit term studied most extensively. It is reasonable to assume that credit users must be aware of annual percentage rates if disclosure of this pricing information is to affect their behavior. An awareness of APRs does not necessarily mean that consumers will change their behavior, but behavioral change resulting from disclosure of APRs is highly unlikely if credit users are not aware of those rates.[7]

Because in interview surveys the annual percentage rates reported by respondents typically cannot be checked against the rates respondents actually pay, researchers associated with the National Commission on Consumer Finance in the 1970s devised the concept of "awareness zones" to measure knowledge of APRs.[8] If a respondent reports an APR within a range deemed, on the basis of a survey of current market practices, to be reasonable, the respondent is characterized as "aware"; if the respondent reports an APR outside the range or answers "do not know," the individual is characterized as "unaware." Although this is an inexact means of measuring awareness of APRs on actual credit card accounts, it does make possible a broad look at the phenomenon as well as comparisons over time.

"Awareness" of APRs on bank-type credit cards, as measured by the awareness-zones method, has increased sharply since implementation of the Truth in Lending Act in 1969 (table 5). In that year, only 27 percent of holders of bank-type credit cards interviewed in a Federal Reserve survey were classified as aware. Awareness more than doubled a year after implementation of the act and has continued to rise since then.

In 1969, 1970, and 1977, consumers were considered aware if they reported a rate greater than 12 percent per year or within the range of 1 percent to 2 percent per month on the card they used most often. For the 2000 survey, the definition of "aware" was changed because rates on credit card balances in many cases are below 12 percent per year—and so-called teaser rates are even lower. Because a very low rate could not be automatically ruled out as the correct current rate, two definitions of awareness were used in 2000. Under the broad definition, only those reporting that they did not know the rate were considered "unaware." Under the narrow definition, those reporting a rate of less than 7.9 percent were also considered unaware. (Using 7.9 percent as the cutoff point may have resulted in an overestimation of unawareness, as some consumers may have actually had a current, "teaser," rate below 7.9 percent: Almost every answer lower than 7.9 percent offered by a respondent ended in .9—for example, 3.9 or

7. For discussion of this topic, see George S. Day, "Assessing the Effects of Information Disclosure Requirements," *Journal of Marketing*, vol. 40 (April 1976), pp. 42–52.

8. See National Commission on Consumer Finance, *Consumer Credit in the United States: The Report of the National Commission on Consumer Finance* (Government Printing Office, 1972); Robert P. Shay and Milton P. Schober, *Consumer Awareness of Annual Percentage Rates of Charge in Consumer Installment Credit: Before and After Truth in Lending Became Effective*, Technical Studies of the National Commission on Consumer Finance, vol. 1, no. 1 (Government Printing Office, 1973); George S. Day and William K. Brandt, *A Study of Consumer Credit Decisions: Implications for Present and Prospective Legislation*, Technical Studies of the National Commission on Consumer Finance, vol. 1, no. 2 (Government Printing Office, 1973).

5. Awareness of annual percentage rates among holders of bank-type credit cards, selected years

Percent aware

Cardholder group	1969	1970	1977	2000	
				Narrow definition	Broad definition
All holders of bank-type cards	27	63	71	85	91
Have a new card account in the past year	...	...	...	83	93
Have three or more cards	...	...	...	89	95
Have an outstanding balance greater than $1,500 after the most recent payment	...	...	...	90	96
Have transferred a balance to another account in the past year[1]	...	...	...	81	98
Hardly ever pay outstanding balance in full	...	...	...	90	96
Hardly ever pay more than the minimum[1]	...	...	...	82	88
Have paid a late fee in the past year	...	...	...	88	95
Have received a collection call in the past year[1]	...	...	...	80	81
Family's annual income is $40,000 to $74,999	...	...	...	90	94
Respondent has high school diploma or some college, but not a degree	...	...	...	86	91
Respondent is 35 to 54 years old	...	...	...	87	92

NOTE. See text for definitions of "awareness."

1. Weighted sample size less than fifty.

. . . Not available.

SOURCE. For 1969 and 1970, Federal Reserve Truth in Lending Surveys; for 1977, Survey of Consumer Finances; for 2000, Surveys of Consumers.

6.9—a sign of a teaser rate. However, this inexactitude on the lower side does not change conclusions very much.) The definition of the upper bound for the 2000 survey is of little practical importance, as only one respondent answered with a rate higher than 25 percent (with a response of 28 percent, this individual was counted as aware).

Under the broad definition of awareness, 91 percent of holders of bank-type credit cards in 2000 are aware of the APR charged on the outstanding balance on the bank-type card they use most often; under the narrow definition 85 percent are aware. Regardless of the definition used in 2000, it is clear that awareness of rates charged on outstanding balances, as measured by the awareness-zones method, has risen sharply since implementation of the Truth in Lending Act.

As with attitudes, awareness of rates varies by behavioral and demographic group. However, awareness exceeds 80 percent for all groups by both the broad and narrow definitions. Groups tending to be less aware (based on the broad definition) include the relatively small group of cardholders who had received a collection call in the past year (81 percent were aware) and those who hardly ever pay more than the minimum amount on their account (88 percent). The group of cardholders who had transferred a balance to another account within the past year registered the highest awareness rate (98 percent), consistent with the belief that balance transfers are more likely among rate-sensitive consumers (and also with the belief that rates on newly transferred accounts are easy to remember).[9] Other groups having relatively high awareness rates include those actually paying the rates, notably, consumers with an outstanding balance of more than $1,500 and those who reported that they hardly ever pay their outstanding balance in full (for both groups, 96 percent). High awareness among these groups is not especially surprising, as consumers who use the credit feature of credit cards, as opposed to just the payment feature, have a clear interest in knowing the cost of the additional service.

Potentially as important as actual awareness is the perception of ease of obtaining information about credit terms. About two-thirds of consumers in the 2000 survey who had bank-type credit cards said that obtaining information on credit terms is easy (table 6). The proportion did not vary greatly or consistently with the way the respondents used credit. Those who had an outstanding balance of more than $1,500 or had transferred a balance from one card to another in the past year were somewhat less likely to report ease in obtaining information, as were those who had received a collection call. Conversely, those who had three or more cards, hardly ever paid more than the minimum amount, or had income in the middle range were slightly more likely to report ease in obtaining information.

9. The large difference between the rates for the narrow and broad measures for this group and also for those with new accounts suggests that some respondents may have been reporting teaser rates and should be counted as aware under the narrow definition, as they were under the broad definition.

6. Opinions about the availability of information about credit cards among holders of bank-type credit cards, 2000
Percent aware

Cardholder group	Information about credit terms		Information needed for wise card use
	Very/somewhat easy to obtain	Very difficult to obtain	Card issuers provide enough
MEMO: All families	67	8	40
All holders of bank-type cards	65	7	46
Have a new card account in the past year	63	8	47
Have three or more cards	69	4	44
Have an outstanding balance greater than $1,500 after the most recent payment	60	5	36
Have transferred a balance to another account in the past year[1]	58	14	42
Hardly ever pay outstanding balance in full	65	7	46
Hardly ever pay more than the minimum[1]	69	11	36
Have paid a late fee in the past year	62	12	36
Have received a collection call in the past year[1]	57	12	28
Family's annual income is $40,000 to $74,999	68	4	45
Respondent has high school diploma or some college, but not a degree	67	3	46
Respondent is 35 to 54 years old	63	8	48

1. Weighted sample size less than fifty.

SOURCE. Surveys of Consumers.

Only 8 percent of all families and 7 percent of holders of bank-type cards believe that obtaining information on credit terms is very difficult. These proportions also vary according to consumer experience and behavior. The proportion is highest for those who have transferred a balance in the past year, those who hardly ever pay more than the minimum due on their accounts, those who have paid a late fee in the past year, and those who have received a collection call in the past year. However, in no case does the proportion rise as high as 15 percent of cardholders.

The proportions of holders of bank-type cards reporting that obtaining information on terms is easy or difficult in 2000 is similar to the proportions in earlier surveys, although in the earlier years the focus was on credit generally rather than credit cards. The proportion of all families indicating in earlier years that obtaining information on credit terms was very easy or somewhat easy ranged from 57 percent to 68 percent, and the proportion indicating that obtaining information was very difficult never rose as high as 10 percent (table 7). The proportion saying that obtaining information was easy was, in all but one year, higher among credit users than among all families, and the proportion saying that obtaining information was very difficult was lower in every year.

The 2000 survey also asked whether credit card companies "usually give enough information to people to enable them to use their credit cards wisely." A bit under half (46 percent) of holders of bank-type cards answered "yes" (table 6). This frequency seemed low in light of the widespread use of credit cards, raising the question of whether the "other guy" effect discussed earlier might be exerting a negative bias. Some consumers might believe that they personally have enough information but that other consumers, who can be counted on to make mistakes when dealing with card issuers, do not. A question focused on the respondents' own experiences might have produced a higher positive response.

To explore these possibilities, two indexes of overall attitudes—one of negativity toward the "other guy" and the other of positiveness about personal experiences—were constructed from responses to

7. Opinions about the ease of obtaining information about credit terms, selected years, 1977–2000
Percent

Group/year	Very/somewhat easy	Very difficult
All families		
1977	58	9
1981	68	7
1984	57	8
1993–4	63	7
1997	59	9
2000	67	8
Credit users[1]		
1977	63	8
1981	78	3
1984	62	1
1993–4	72	5
1997	72	3
2000	65	7

NOTE. For 2000, ease of obtaining information about *credit card* terms; for all other years, information about *credit* terms.

1. For 1977, families with (closed-end) installment debt outstanding; for 1981, 1993–94, and 1997, families that had incurred (closed-end) installment debt in the past year; for 1984, families that had made a purchase on the installment plan in the past year; for 2000, holders of bank-type credit cards.

SOURCE. For 1977, Survey of Consumer Finances; for all other years, Surveys of Consumers.

statements about "card issuers and consumers in general" and "card issuers and me" (see table 4). For each of the five statements in the former category, which are framed to reflect negatively on issuers and consumers, a value of –2 was assigned to each "strongly agree" response and a value of –1 was assigned to each "agree" response; other responses were assigned a value of zero. The values were then summed for each respondent, giving an index value within a range of –10 to zero for that respondent. The respondents were then divided into two groups, "strongly negative" (an index value of –7 through –10, characterizing about 42 percent of holders of bank-type cards) and all others. A similar but positive index was constructed from the favorable responses to the statements about personal experiences ("card issuers and me" in table 4); and the respondents were similarly divided into two groups, "strongly positive" (about 49 percent of holders of bank-type cards) and all others.

Respondents who were not strongly negative about other consumers were in fact somewhat more likely to believe that card issuers give cardholders enough information to enable them to use their credit cards wisely; 52 percent of this group answered this way, compared with 46 percent of all cardholders. Of the group with a strongly positive index for personal experiences, 55 percent said issuers provide enough information (figures not in the tables). Although the differences are not dramatic, it does seem likely that the "other guy" effect exerts a downward bias on views as to whether credit card issuers provide enough information. Even with the possible downward bias, about two-fifths of all families in 2000 believe that creditors provide enough information.[10]

Holders of bank-type credit cards who said either that card issuers do not provide enough information or that they do not know were also asked a follow-up question: "What kind of information do you think would be helpful?" The wording of the question permits thinking about other consumers as well as more personally. The responses suggest a concern about the clarity of already available information (table 8), raising a question as to whether the required information provided now is so extensive and frequent that it is almost overwhelming. Those who said that more information would be helpful simultaneously seem to be saying that they do not understand the information already provided, as many of the features they said would be helpful—clear statement of interest rates and changes in rates, and a clear definition of fees for cash advances and other services, for example—are already required by disclosure regulations. Respondents indicating that credit counseling and information about overextension would be useful could be expressing concern for others as well as for themselves.

8. Proportion of holders of bank-type credit cards believing that specific actions to provide more information would be helpful, 2000

Percent

Action	Bank-type card holders who said more information would be helpful	All bank-type card holders
Clearly state interest rates and changes in interest rates	35	19
Clearly define fees and charges	15	8
Make fine print bigger	12	6
Offer credit counseling	12	6
Provide more information about overextension	14	8
Give information about costs if only the minimum amount is paid	11	6
All other responses	14	8

NOTE. Respondents were allowed to answer with up to two responses.
SOURCE. Surveys of Consumers.

Information about Payoff Times

Some observers have proposed that the Truth in Lending Act be amended to require card issuers to disclose to cardholders the period of time necessary to pay off a credit card balance if only the minimum amount is paid each month. Consumers indicate that they would like to have this information. However, precision in such a figure would imply that the consumer would not add to the balance in subsequent months (an assumption that also might be disclosed). If the consumer makes the minimum payment but continues to use the card, and the balance fluctuates substantially, the disclosure would in many cases be inaccurate. Of course, some consumers who rarely pay the balance in full might, nonetheless, benefit from an imperfect glimpse of the length of time necessary to repay in full.

To learn about consumers' behavior with respect to paying balances and the likelihood of their ceasing to

10. It is also possible to examine the association of strongly negative and positive attitudes with overall beliefs that credit cards are good or bad (the measurement in table 3). Notably, 55 percent of those in the strongly negative group (that is, those who expressed negativity on the questions about consumers) believe that credit cards are "bad" (a percentage much higher than that for the population as a whole), compared with 35 percent of those in the strongly positive group (that is, those who feel positive about their personal experiences) (much lower than the percentage for the population as a whole).

use the card after paying only the minimum amount, questions on this subject sponsored by the Federal Reserve were asked in the monthly Surveys of Consumers undertaken by the Survey Research Center of the University of Michigan in the summer of 1999, and identical questions sponsored by the Credit Research Center were included in the Surveys of Consumers in January 2000. In all, 2,000 consumers were questioned. Findings that 73 percent had a credit card of some type and 69 percent had a bank-type card correspond well with results of the 1998 Survey of Consumer Finances.

Just over one-third (35 percent) of holders of bank-type cards said they hardly ever pay their balance in full, somewhat higher than the 27 percent found in the 1998 Survey of Consumer Finances. Nine percent of cardholders reported that they sometimes pay more than the minimum amount due, and only 7 percent said they hardly ever pay more than the minimum.

Card-related behaviors among holders of bank-type credit cards, 1999 and 2000

Behavior	Percent
Hardly ever pay outstanding balance in full	35
Sometimes pay more than the minimum	9
Hardly ever pay more than the minimum	7
Sometimes or hardly ever pay more than the minimum, and do not use the card if making minimum payment	9
Hardly ever pay more than the minimum, and do not use the card if making minimum payment	4

SOURCE. Surveys of Consumers, June–August 1999 and January 2000.

As discussed earlier, those who would benefit most directly from information about the length of time it would take to pay off a revolving account by making only the minimum payment each month would be card users who pay the minimum and then do not make additional charges (as noted, if they continued to use the accounts, the length of time to repay would change). Survey findings indicate that 9 percent of holders of bank-type cards are in this category. If only those who say they hardly ever pay more than the minimum are considered, the proportion who report that they stop using the card falls to 4 percent of holders of bank-type cards.

CONCLUSION

The holding and use of general-purpose credit cards with a revolving feature, as well as balances outstanding, have increased substantially over the past three decades. These "bank-type" credit cards are, to some extent, a substitute for the installment-purchase plans formerly offered by retail stores. Consumers apparently like the convenience associated with card-based open-end credit lines, but they also express concerns. Some of their concerns may arise from personal experiences, but some also apparently come from perceptions of the difficulties of other consumers. Many consumers, by one measure of one important credit cost term, are aware of the costs associated with the use of revolving credit, and most consumers say that obtaining information on credit card terms is not very difficult. Responses to consumer interviews suggest that attitudes toward credit cards and card companies are similar to attitudes about closed-end credit in an earlier generation. Credit and creditors are never universally popular, it seems, even among users, and technological change in credit issuance has not altered this observation. □

The Profitability of Credit Card Operations of Depository Institutions

An Annual Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988.

June 2001

Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988 directs the Federal Reserve Board to transmit annually to the Congress a report about the profitability of credit card operations of depository institutions.[1] This is the eleventh report. The analysis here is based to a great extent on information from the Consolidated Reports of Condition and Income (Call Report) and two Federal Reserve surveys, the Quarterly Report of Credit Card Interest Rates and the Survey of Terms of Credit Card Plans.

Call Report Data

Every insured commercial bank files a Call Report each quarter with its federal supervisory agency. The Call Report provides a comprehensive balance sheet and income statement for each bank; however, it does not allocate all expenses or attribute all revenues to specific product lines, such as credit cards. Nevertheless, the data may be used to assess the profitability of credit card activities by analyzing the earnings of those banks established primarily to issue and service credit card accounts. These specialized banks are referred to here as "credit card banks."

For purposes of this report, credit card banks are defined by two criteria: (1) the bulk of their assets are loans to individuals (consumer lending), and (2) 90 percent or more of their consumer lending involves credit cards or related plans. Given this definition, it can reasonably be assumed that the profitability of these banks primarily reflects returns from their credit card operations.

The first credit card banks were chartered in the early 1980s, and the vast majority have been in operation only since the mid-1980s. To provide a more reliable picture of the year-to-year changes in the profitability of the credit card operations of card issuers, this report limits its focus to credit card banks having at least $200 million in assets. Most of these institutions have been in continuous operation for several years, particularly those with assets exceeding $1 billion, and are well beyond the initial phase of their operations.

As of December 31, 2000, twenty-eight banks with assets exceeding $200 million met the definition of a credit card bank. At that time, these banks accounted for roughly 72 percent of outstanding credit card balances on the books of commercial banks or in pools underlying securities backed by credit cards. The dollar amount of all credit card debt held by large credit card banks increased nearly 20 percent from 1999; and the share of all such debt held by these specialized banks increased roughly 5 percent from the previous year.[2]

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1. P.L. 100-583, 102 Stat. 2960 (1988). The 2000 report covering 1999 data was not prepared as a consequence of the Federal Reports Elimination and Sunset Act. The report was subsequently reinstated by law.

2. The increase in market share of the credit card banks primarily reflects growth in assets among firms that were identified as large credit card banks in previous years. Some of this growth was achieved by the purchase of other lenders' portfolios, some by internal growth of existing and new credit card plans. In addition, two institutions were added to the panel of credit card specialists for the year 2000, replacing

(continued...)

In 2000, credit card banks with assets in excess of $200 million reported net earnings before taxes of 3.14 percent of outstanding balances adjusted for credit card-backed securitization.[3] As table 1 shows, returns on credit card operations for these large credit card banks declined 20 basis points or 6 percent from 1999. Returns on credit card operations in 2000, while lower than in the previous year, still compare favorably with returns during the mid-1990s. However, returns on credit card operations remain below their high point attained in 1993.

Although credit card profitability has fallen substantially since 1993 for the large credit card banks, credit card earnings compare favorably to returns on all commercial bank activities.[4] For all commercial banks, the average return on all assets, before taxes and extraordinary items, was 1.81 percent in 2000.[5]

One problem that arises in assessing changes in profitability over time is that the sample of credit card banks may change somewhat from one year to the next. Thus, overall changes in profit rates from year to year reflect both real changes in activity and changes in the sample. To evaluate the effects of sample changes, the profitability of the specific banks included in the 2000 sample was examined over the period from 1986 to 2000 as well. Although the level of reported profitability for the constant panel of banks is somewhat different from that shown in table 1, the intertemporal pattern of profitability remains essentially as shown in the table. For 2000, returns for the constant sample declined 5.4 percent from 1999.

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2. (...continued)
two firms that dropped off the panel. Both of the new firms were relatively small, having assets below $500 million.

3. Calculations are adjusted for securitizations because earnings as reported on the Call Report reflect revenues and expenses from outstandings both on the books of the institutions and in off-balance-sheet pools backing securities.

4. This report focuses on the profitability of large credit card banks, although many other banks engage in credit card lending without specializing in this activity. Reliable information on the profitability of the credit card activities of these other banks is not available, although their cost structures, pricing behavior, and consequently their profitability may differ from that of the large, specialized issuers. The relatively high returns of credit card banks are not surprising, since one would expect that monoline institutions, such as credit card banks, would need to earn higher returns to compensate for the greater risks of holding an undiversified (by credit line) portfolio.

In previous annual reports on credit card profitability, information from the Federal Reserve's Functional Cost Analysis (FCA) Program was used to measure the profitability of the credit card activities of smaller credit card issuers. These data tended to show credit card activities were less profitable for smaller issuers than for larger ones. The FCA program was discontinued in the year 2000. For further discussion, see Glenn B. Canner and Charles A. Luckett, "Developments in the Pricing of Credit Card Services," *Federal Reserve Bulletin*, vol. 78, no. 9 (September 1992), pp. 652-666.

5. See William F. Bassett and Egon Zakrajsek, "Profits and Balance Sheet Developments at U.S. Commercial Banks in 2000," *Federal Reserve Bulletin*, vol. 87, no. 6 (June 2001).

1 Net before-tax earnings as percentage of outstanding balances for large credit card banks (adjusted for credit card securitizations), 1986-2000[1]

Year	*Earnings*[2]	*Year*	*Earnings*
1986	3.45	1994	3.98
1987	3.33	1995	2.71
1988	2.78	1996	2.14
1989	2.83	1997	2.13
1990	3.10	1998	2.87
1991	2.57	1999	3.34
1992	3.13	2000	3.14
1993	4.06		

1. Credit card banks are defined as commercial banks that have assets greater than $200 million, have the bulk of their assets in loans to individuals (consumer lending), and have 90 percent of their consumer lending in credit cards and related plans. For credit card banks, outstanding balances are adjusted to include balances underlying credit card securities. Outstanding balances reflect an average of the four quarters for each year.
2. Figures may differ from those presented in prior year reports as the result of revisions to the Reports of Condition and Income.

Source: Reports of Condition and Income, 1986-2000, and data on securitizations.

Changes from 1999 in overall returns to credit card operations can be better understood by reviewing how individual expense and revenue items changed.[6] Credit quality problems put pressure on credit card earnings in 2000, with much of the decline in profitability resulting from increased provisions for future loan losses. Provisions for future losses as a percent of assets increased 5 percent from the 1999 levels. The increase in provisions for future losses suggests that banks' are anticipating credit quality problems with their existing portfolios. This interpretation is supported by the data pertaining to delinquency rates: the 30-day to 89-day delinquency rate for credit card plans at large credit card banks increased from 3.02 percent in 1999 to 3.15 percent in 2000.

At the same time that provisions for future losses were increasing for large credit card banks, overall expenses per dollar of assets also increased. Interest expenses rose 19 percent from 1999, noninterest expenses increased a more modest 2 percent. On the revenue side of the income statement, interest income as a percent of assets increased from the 1999 level by 6 percent. Also acting to offset some of the increase in costs was a small increase, about

6. For another assessment of changes in credit card revenues and expenses, see James J. Daly, "Tenuous Gains in Card Profitability," *Credit Card Management*, May 2001, pp. 32-33.

1 percent, in income derived from noninterest sources such as fees, merchant discounts, and credit card securitizations. Among the various types of fee income, penalty fees, such as late payment fees, and cash advance fees increased over 1999 levels.

General Discussion

Thousands of firms offer bank cards to consumers.[7] Prior to the early 1990s, card issuers competed primarily by waiving annual fees and providing credit card program enhancements. Since then, however, interest-rate competition has played a much more prominent role. Many credit card issuers, including nearly all of the largest issuers, have lowered interest rates on many of their accounts below the 18 to 19 percent levels commonly maintained through most of the 1980s and early 1990s. Credit card interest rates in general have become more responsive to issuers' costs of funds in recent years as more issuers have tied their interest rates directly to one of several indexes that move with market rates (currently, about three-fifths of card issuers tie their interest rates on their largest credit card plans to a market index). Some issuers have segmented their cardholder bases according to risk characteristics, offering reduced rates to existing customers who have good payment records while maintaining relatively high rates for higher-risk, late-paying cardholders. Moreover, many issuers have attempted to gain or maintain market share by offering very low, temporary rates on balances rolled over from competing firms. Trends in credit card pricing are discussed in more detail below.

Over the past several years, competition has led to substantial shifts in market shares among the industry's largest firms. Most of the larger issuers have grown by acquiring credit card portfolios from smaller issuers or by merging with other firms. In addition, several of the more rapidly growing firms in recent years appear to have attracted market share by offering comparatively low-rate cards and attractive balance transfer programs. Others have gained market share through co-branding and associated rebate strategies, typically combined with waivers of annual fees.[8]

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7. Currently, roughly 6,800 depository institutions issue VISA and MasterCard credit cards and independently set the terms and conditions on their plans. Close to 10,000 other institutions act as agents for card-issuing institutions. In addition to the firms issuing cards through the VISA and MasterCard networks, two large nonbank firms, American Express Co. and Morgan Stanley Dean Witter and Co., issue independent general purpose credit cards to the public.

8. Under co-branding programs, the credit card bears the name of and is marketed to consumers of the co-branded product(s). Through use of the card, consumers typically accumulate "points" good for

(continued...)

Aggressive competition for new customers during 2000 was at least partly the cause of a 8 percent increase from 1999 in the number of VISA and MasterCards in circulation, to a total of 452.9 million.[9] The number of credit cards per cardholder also increased slightly, rising to an estimated 4.2 credit cards per person. The large number of direct mail solicitations, up significantly from 1999 levels, demonstrates the continuing desire of card issuers to expand and retain their base of cardholders.[10] In 2000, credit card issuers were particularly focused on promoting "platinum" cards to either retain or expand their business. Solicitations for these more upscale cards that include a wide variety of enhancements and high credit limits accounted for more than half of all direct mail solicitations in 2000, up sharply from only 6 percent of all solicitations in 1996, but down some from 1999 levels. Solicitations for "gold" cards and targeted mailings to the subprime market also contributed to the record volume of credit card solicitations. While credit card holding continued to grow from 1999 to 2000, the rate of growth has moderated, consistent with the view that the market is becoming relatively saturated.

Recent Trends in Credit Card Pricing

Aside from questions about the profitability of credit card operations, considerable attention has been focused on credit card pricing and how it has changed in recent years. Analysis of the trends in credit card pricing in this report focuses on credit card interest rates because they are the most important component of the pricing of credit card services. Credit card pricing, however, involves other elements, including annual fees, fees for cash advances, rebates, minimum finance charges, over-the-limit fees, and late payment charges.[11] In addition, the length of the "interest-free" grace period, if any, can have an important influence on the amount of interest consumers pay when they borrow on their credit cards.

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8. (...continued)
rebates on purchases of the co-branded product(s). One popular type of co-branding is with airline companies; in this case, "frequent-flier miles" are earned through credit card purchases.

9. Figures exclude debit cards. Source: *The Nilson Report*, April 2001.

10. An estimated 3.54 billion direct mail solicitations were sent by issuers during 2000, up significantly (about 23 percent) from about 2.87 billion in 1999. The response rate on credit card solicitations in 2000 was estimated to be 0.6 percent, slightly lower than in 1999 but down sharply from an average of 2.5 percent over the period 1990 to 1993. Source: "Credit Card Mail Volume Hits All Time High in 2000, As Response Rates Decline to New Low," *BAI Global, Inc.*, press release, March 2001.

11. In June 1996, the Supreme Court ruled that states may not regulate the fees charged by out-of-state credit card issuers. States have not been permitted to regulate the interest rates out-of-state banks charge. In making its decision, the Court supported the position previously adopted by the Comptroller of the Currency that a wide variety of bank charges, such as late fees, membership fees, and over-the-limit fees, are to be considered interest payments. This ruling will likely ensure that banks will continue to price credit cards in multidimensional ways rather than pricing exclusively through interest rates. Source: Valerie Block, "Supreme Court Upholds Nationwide Card Charges," *American Banker*, June 4, 1996.

Over the past several years, pricing practices in the credit card market have changed significantly. Many card issuers that in the past offered programs with a single interest rate now offer a broad range of card plans with differing rates depending on credit risk and consumer usage patterns. Moreover, as noted, many issuers have also moved to variable-rate pricing that ties movements in their interest rates to a specified index such as the prime rate.

At present, the Federal Reserve collects information on credit card pricing through two surveys of credit card issuers. Because of the significant changes in the pricing of credit card services, the Federal Reserve initiated the Quarterly Report of Credit Card Interest Rates (FR 2835a) at the end of 1994. This new survey collects information from a sample of credit card issuers on (1) the average nominal interest rate and (2) the average computed interest rate. The former is the simple average interest rate across all accounts; the latter is the average interest rate paid by those card users that incur finance charges. These two measures can differ because some cardholders are convenience users who pay off their balances during the interest-free grace period and therefore do not typically incur finance charges. Together, these two new interest rate series provide a better measure of credit card pricing. The Federal Reserve also collects detailed information on the pricing features of the largest credit card plan of a sample of issuers through the Survey of Terms of Credit Card Plans (FR 2572).[12]

Because information from the FR 2835a survey does not have an extended historical interest rate series for comparison purposes, this report on credit card profitability also presents data from the survey that preceded and was replaced by the FR 2835a, the Federal Reserve's Quarterly Report of Interest Rates on Selected Direct Consumer Installment Loans (FR 2835). Data from the FR 2835 indicate that credit card interest rates fell sharply from mid-1991 through early 1994 after being relatively stable for most of the previous twenty years (table 2).[13] Since early 1994, credit card interest rates have fluctuated in a narrow range between 14.32 and 16.25 percent. For 2000, credit card interest rates averaged 14.91 percent, the second consecutive year such rates have averaged below 15 percent. It should be emphasized that the interest rates reported after August 1994 are based on the new survey and are not directly comparable to the interest rates reported on the older survey.

The general decline in credit card interest rates from mid-1991 is the result of many factors, including greater competition on this aspect of credit card pricing. The decline in rates also reflects, in large measure, the sharp drop in credit card issuers' costs of funds in the early part of this period. Reflecting movements in short-term interest rates for the year 2000, issuers'

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12. The information in the FR 2572 survey is published twice a year by the Federal Reserve. Historically, the data were made available in a statistical release, the E.5 "Report of the Terms of Credit Card Plans." Beginning in 1995, the E.5 statistical release was discontinued and data are now included in a consumer brochure, entitled "Shop: The Card You Pick Can Save You Money."

13. For a comprehensive discussion of the factors that account for the levels and changes in credit card interest rates see, Glenn B. Canner and Charles A. Luckett, "Developments in the Pricing of Credit Card Services"; also U.S. General Accounting Office, *U.S. Credit Card Industry* (GAO/GGD-94-23, 1994).

costs of funds fluctuated over a fairly narrow band. Costs of funds in 2000 were somewhat higher than in 1999.

Additional evidence on changes in credit card interest rates comes from the FR 2572. Although not precisely comparable from period-to-period because of changes in the sample of reporters, this statistical series reveals a general decline in credit card interest rates in recent years. For example, only 11 percent of the respondents reported interest rates below 16 percent on their largest credit card plan as of September 1991, but three-fifths did so as of January 2000 (the latest report available). In addition, the proportion of card issuers reporting that they utilize variable-rate pricing has also increased substantially since September 1991. As of September 1991, 23 percent of issuers used variable-rate pricing; as of January 2000, the proportion was 56 percent. The increased use of variable-rate pricing suggests credit card rates are likely to respond more quickly to changes in market interest rates in the future than they have in the past.

2. Average Most Common Interest Rate on Credit Card Plans, 1972-August 1994, and the Interest Rate Assessed on Accounts Incurring Interest Charges, November 1994-2000*

Percent

Year	*Interest rate*	*Year*		*Interest rate*
1972	17.21	1995	February	15.29
1973	17.21		May	16.23
1974	17.20		August	15.94
1975	17.16		November	15.71
1976	17.05			
1977	16.88	1996	February	15.41
1978	17.03		May	15.41
1979	17.03		August	15.64
1980	17.31		November	15.52
1981	17.78			
1982	18.51	1997	February	15.13
1983	18.78		May	15.72
1984	18.77		August	15.79
1985	18.69		November	15.62
1986	18.26			
1987	17.92	1998	February	15.33
1988	17.78		May	15.62
1989	18.02		August	15.85
1990	18.17		November	15.72
1991	18.23			
1992	17.78	1999	February	14.73
1993	16.83		May	14.94
1994	15.77		August	14.79
1995	15.79		November	14.77
1996	15.50			
1997	15.57	2000	February	14.32
1998	15.59		May	14.74
1999	14.81		August	15.35
2000	14.91		November	15.23

*Prior to November 1994 interest rates were those reported in the Quarterly Report of Interest Rates on Selected Direct Installment Loans. Beginning in November 1994 interest rates are those reported on the Quarterly Report of Credit Card Interest Rates for those credit card holders incurring interest charges.

Source: Board of Governors of the Federal Reserve System

PREPARED STATEMENT

OF THE FEDERAL TRADE COMMISSION

Before the

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

UNITED STATES HOUSE OF REPRESENTATIVES

Washington, D.C.

November 1, 2001

I. Introduction

Mr. Chairman and members of the Committee, I am Elaine Kolish, Associate Director of the Bureau of Consumer Protection's Division of Enforcement at the Federal Trade Commission.[1] I am pleased to have this opportunity to provide information concerning the Commission's recent enforcement action against Ira Smolev, Triad, and related parties.[2] That case was brought as part of the Commission's crackdown on deceptive negative option marketing programs that fail to disclose, or to disclose adequately, the terms of negative option or "free trial" offers. These practices have resulted in consumers being charged or billed for goods and services without authorization.[3] Negative option marketing is particularly troubling when marketers, as they did in the *Smolev* case, already have consumers' credit card or billing account information and can easily charge consumers' accounts without their permission or when marketers fail to disclose that consumers' credit card numbers will be transferred to another company and charged unless consumers call to cancel.

This testimony describes the *Smolev* case and other recent Commission actions involving deceptive negative option marketing and the deceptive sale of credit cards and credit card loss protection services. In addition, this statement describes FTC consumer education materials designed, for example, to help consumers understand negative option offers and minimize the risk of having their billing information transferred or used without their knowledge or consent.

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[1]The views expressed in this statement represent the views of the Commission. My oral statement and responses to any questions you may have are my own, and do not necessarily represent the views of the Commission or of any individual Commissioner.

[2]*FTC v. Ira Smolev,* No. 01-8922 CIV ZLOCH (S.D. Fla.) (filed Oct. 23, 2001).

[3]A negative option is any type of sales term, contract provision, or buying plan that requires an affirmative action on the consumer's part to prevent a sale from taking place. This type of marketing is legal as long as the seller clearly discloses all the material terms and conditions up front and the consumer accepts the offer.

II. Background

The FTC is the federal government's primary consumer protection agency. Congress has directed the FTC, under the FTC Act, to take action against "unfair or deceptive acts or practices" in almost all sectors of our economy and to promote vigorous competition in the marketplace.[4] As part of our activity, the Commission monitors complaints about all types of negative option marketing. Although the number of complaints in this general area has been increasing, one of the specific segments with a particularly dramatic increase in complaints is buying clubs. Buying clubs provide members with specified benefits over a period of time, including, for example, discounts on goods, health services, and legal services. From 1998 to 2000, buying clubs jumped from the 26th to the 11th most frequently complained about subject in the FTC's Consumer Sentinel complaint database. Thus, this area has attracted increased FTC attention, as well as the attention of the State Attorneys General.

III. *Smolev/Triad* Case and Negative Option Marketing

On October 24, 2001, the FTC announced that a group of buying clubs including Triad Discount Buying Service, Inc., its related companies and their operator, Ira Smolev, will pay more than $9 million to settle charges brought by the FTC and State Attorneys General that the defendants misled consumers into accepting trial buying club memberships and obtained consumers' credit card account numbers without the consumers' knowledge or authorization

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[4]The FTC has broad law enforcement responsibilities under the FTC Act, 15 U.S.C. § 41 *et seq*. The statute provides the agency with jurisdiction over most of the economy. Certain entities, such as depository institutions and common carriers, are wholly or partially exempt from FTC jurisdiction, as is the business of insurance. In addition to the FTC Act, the FTC has enforcement responsibilities under more than 40 statutes.

from telemarketers pitching the buying clubs. [5] Consumers then were enrolled in the clubs and charged up to $96 in yearly membership fees. Of the amount to be paid, $8.3 million is earmarked for consumer restitution, and $750,000 will cover state investigative costs. The multi-state investigation, which was led by Florida and Missouri, resulted in more than 40 states' entering into the settlement agreement.

From 1996 to 2000, the Triad companies contracted with numerous independent telemarketers to "upsell"[6] the Triad buying clubs. The telemarketers generally marketed their own products and services through outbound calls or inbound calls in response to advertising, direct mail, or infomercials. After customers purchased products or services from these telemarketers and provided their credit card numbers for payment, the telemarketers promoted a 30-day free trial in the Triad buying club as a thank-you for purchasing the telemarketers' products or services. The Commission's complaint alleges that the telemarketing scripts did not disclose or disclose sufficiently that consumers had to call the defendants and cancel their

[5]The press release and related documents are available at www.ftc.gov/opa/2001/10/triad.htm. Specifically, the complaint alleges that defendants misrepresented that: (1) consumers who agree to the offer of a 30-day trial membership incur no obligation to take any action to avoid having their credit cards charged for the membership; (2) consumers agreed to accept the trial memberships, or agreed to purchase memberships, for which defendants charged them; and (3) only the cost of the products purchased from defendants' third-party telemarketers would be charged to the consumers' credit card accounts and no other charges to the accounts would be made without the consumers' further express authorization. The complaint also alleges that defendants failed to disclose or to disclose adequately that a consumer who fails to contact defendants within 30 days and cancel the membership is automatically enrolled as a member and charged an annual fee, and that the member is charged a renewal fee each subsequent year unless the member cancels the membership. In addition, it alleges that defendants, directly and through their third-party telemarketers, failed to disclose that the consumers' financial information is turned over to defendants, who charge the consumer's credit card for the membership. Finally, the complaint alleges that defendants violated the Telemarketing Sales Rule ("TSR") by not disclosing material terms and conditions of the offers up front.

[6]Upselling is the practice of marketing additional products after a consumer has agreed to purchase a different product. In this case, for example, two sellers entered into a joint marketing agreement to offer products or services during the same telephone call. The first seller telemarketed its own products or services. After consumers provided financial information to pay for their orders, the first seller offered the second seller's products or services.

membership before the end of the trial period to avoid being automatically enrolled as a member and charged an annual fee. In addition, consumers were unaware that their credit card numbers were being transferred from the telemarketer they called to Triad.

In addition to providing monetary relief, the Triad Order requires Ira Smolev and the Triad companies to drastically revise their marketing practices to prevent future deception. The Order prohibits them from misrepresenting "free" offers of goods or services and from failing to disclose any obligations placed on consumers who accept trial offers. The Order also prohibits them from: (1) obtaining consumers' billing information, including credit card account numbers and unique identifying information, from third parties without the consumers' express authorization; (2) disseminating the information (with a few narrow exceptions, such as to process an authorized charge); and (3) signing up new members or renewing existing memberships without express, verifiable authorization from the consumer.[7]

In addition to the FTC and state actions against Triad, since 1999 several states have taken enforcement action against three other buying club marketers, Damark International,[8]

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[7]The Order also enjoins violations of the Telemarketing Sales Rule, and requires Ira Smolev and the Triad companies to retain a third party monitor to oversee their future business operations and report to the FTC. Finally, the Order requires Ira Smolev to maintain a $1.5 million escrow account before he markets goods or services to the general public or assists others engaging in telemarketing.

[8]In 1999, Minnesota obtained an Assurance of Discontinuance from Damark International to resolve allegations that it deceived consumers by offering a free trial membership in its buying clubs without disclosing that consumers must affirmatively act to cancel the membership within 30 days to avoid a credit card charge.

MemberWorks[9] and Brand Direct Marketing ("BDM"),[10] based on their marketing practices. These matters involved alleged practices like those at issue in the *Smolev* matter.

The FTC and State Attorneys General are continuing to investigate other companies that are engaged in negative option marketing, including offers for buying clubs, that may be misleading to consumers. Past FTC cases have involved book offers,[11] website services,[12] and Internet services,[13] among others. On October 4, during remarks at the 2001 Privacy Conference

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[9]At least four states -- Minnesota, New York, Nebraska, and California -- have obtained either an Assurance of Voluntary Compliance ("AVC") or a court settlement with MemberWorks. Nebraska obtained an AVC in February 2001 that applies nationwide. The AVC requires MemberWorks to provide refunds to consumers alleging unauthorized charges and includes detailed conduct provisions applicable to MemberWorks' marketing of membership programs.

[10] In August 2000, BDM agreed to be bound by a federal court order resolving allegations that BDM violated the TSR and state consumer protection laws. *State of Connecticut and State of Washington v. Brand Direct Marketing, Inc.*, No. 300CV1456-GLG (D. Conn., Aug. 9, 2000). The states filed this action in federal court to enforce the TSR pursuant to the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. §6101 *et seq.* The states have authority to bring such TSR enforcement actions under 15 U.S.C. § 6103(a). Pursuant to this Order, BDM paid $1.9 million in penalties, fees and consumer education funds, and about $11 million in restitution. In addition, BDM is required to make specific disclosures about its ability to directly charge consumers' credit cards. Finally, the order requires BDM to improve its cancellation, automatic renewal, and refund procedures.

[11]For example, the Commission recently obtained a consent decree against a book company for allegedly violating the Prenotification Plan Negative Option Rule, 16 C.F.R. Part 425, the TSR, and the Unordered Merchandise Statute, 39 U.S.C. § 3009. *FTC v. Creative Publishing Int'l, Inc.*, No. 01-945 (DWF/AJB) (D. Minn. May 30, 2001). That case involved allegations that consumers were not told all the terms and conditions of the plan they were unwittingly signed up for when they agreed to receive a book on a free preview basis. Those consumers who paid for the book were sent notices, without their authorization, that other books would be sent to them unless they cancelled.

[12]*See e.g., FTC v. Shared Network Services, LLC*, No. CIV. S-99-1087 WBS JFM (E.D. Cal.); *FTC v. Wazzu Corp.*, No. SACV-99-762-AHS (C.D. Cal.); and *FTC v. U.S. Republic Communications, Inc.*, No. 4:99-CV-3657 (S.D. Tex.). The defendants in these cases represented that small businesses would have an opportunity to review website services for a 30-day trial period before being charged for the services. The defendants made it nearly impossible for businesses to cancel, however, by failing to provide information about how to contact the defendants or by providing that information weeks after the telemarketing call.

[13]In 1998, the Commission challenged the free trial-period marketing practices of three Internet Service Providers ("ISPs"). The Commission alleged that the ISPs failed to disclose adequately that consumers who do not cancel free Internet services during a 30-day trial period would incur charges on their credit cards (the consumers provided their credit card numbers to the ISPs to initiate the free trial periods). The consent orders require the ISPs to disclose clearly and prominently any obligation to cancel the service in order to avoid being charged, and to provide at least one reasonable means of canceling. *See America Online, Inc.*, No. C-3787, *Prodigy Servs. Corp.*,

(continued...)

in Cleveland, Ohio,[14] FTC Chairman Muris announced that, as part of the FTC's review of the Telemarketing Sales Rule, he will recommend consideration of amendments to address abuses concerning pre-acquired account information to ensure that this type of information is not used to bill consumers for goods or services they did not want.[15]

IV. Actions Involving Credit Card Sales and Credit Card Loss Protection Services

The FTC has aggressively challenged deceptive marketing of credit and credit card-related services. Most recently, on October 18, 2001, the FTC announced the filing of nine cases, most of which involve the alleged deceptive telemarketing of "guaranteed loans," worthless credit card protection services, and "protection" from identity theft.[16]

The FTC has brought cases challenging the deceptive marketing by telemarketers of major credit cards, such as VISA and MasterCard. For example, in January 2001, the Commission obtained a settlement with American Consumer Membership Services, Inc. and its principal resolving charges that they deceptively telemarketed offers of pre-approved, guaranteed VISA or MasterCard credit cards for a $69 fee to consumers with credit problems. Instead of the promised cards, consumers received vouchers, coupons, and other offers, and occasionally credit card applications with lists of banks to which they could apply for a credit card. Applying for these credit cards often required additional bank fees of as much as $150. The settlement bans the defendants from engaging in any telemarketing, or in the advertising,

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[13](...continued)
No. C-3788, and *CompuServe, Inc.*, No. C-3789 (Mar. 16, 1998).

[14]Chairman Muris' remarks can be found at www.ftc.gov/speeches/muris/privisp1002.htm.

[15]16 C.F.R. Part 310. As with any rulemaking, the Commission will carefully consider the record developed during the proceeding before making a final decision.

[16]The press release announcing the "Ditch the Pitch" cases is at www.ftc.gov/opa/2001/10/ditch.htm.

marketing, or sale of credit cards, loans or other extensions of credit. In addition, it requires the payment of over $40,000 in consumer redress.[17] In other similar cases, the FTC alleged that the companies misrepresented that consumers whose credit cards are lost or stolen are at risk for unlimited charges, when in fact under the Truth-in-Lending Act consumers are not responsible for any unauthorized credit card charges over $50, and major credit card companies typically waive this fee too.

V. Consumer Education

To help consumers protect themselves, the Commission has widely disseminated numerous consumer education publications.[18] To help consumers understand negative option and trial offers and reduce the risk of having their credit card numbers transferred or charged without authorization, the Commission has issued two publications – "Prenotification Negative Option Plans" and "Trial Offers: The Deal is in the Details." The FTC also has issued consumer education materials addressing the deceptive marketing of gold credit cards and credit card loss protection programs, including "Gold and Platinum Cards;" "Secured Credit Card Marketing Scams;" and "FTC Consumer Alert! Credit Card Loss Protection Offers: They're the Real Steal." We hope that consumers who may have had their credit card numbers transferred or charged without their knowledge or consent will report their experiences by filing a complaint with the FTC. Consumers who feel that they have been defrauded can file complaints with the FTC in writing, online at www.ftc.gov, or by calling the FTC's toll-free number, 1-877- FTC HELP. Information about where such practices are occurring and which companies are engaging

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[17] *FTC v. American Consumer Membership Services, Inc.*, No. 99 CV 1206 (N.D.N.Y.) (complaint filed Aug. 5, 1999).

[18] These publications are available at www.ftc.gov/bcp/conline/pubs.

in them is critical to effective state and federal law enforcement efforts.[19]

VI. Conclusion

The Commission appreciates the opportunity provided by the Subcommittee to describe our efforts to tackle the deceptive marketing of negative option and free trial offers and the improper transfer or misuse of consumers' billing information, as well as other deceptive practices involving the sale of credit cards and credit card loss protection services.

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[19]Recently issued voluntary self-regulatory guidelines also may help address and prevent deception and consumer confusion over negative option marketing practices, as well as the use of pre-acquired account information. On October 14, 2001, the Electronic Retailing Association's board approved industry self-regulatory guidelines that address negative option marketing (called advance consent marketing by the industry), made compliance with them a condition of membership, and advised members not to do business with other companies not adhering to the guidelines. In addition, the Magazine Publishers Association and companies such as Time-Life have formally adopted the guidelines, and it appears that other companies and associations also may do so. These guidelines explain the disclosures that are required for various types of negative option marketing (*e.g.*, automatic renewals, free trial offers) and advise sellers "to be sensitive to the privacy concerns of consumers and regulators in connection with the use and disclosure of consumers' account billing information." The guidelines further provide that "sellers and their agents and their service providers should not transfer a consumer's account billing information to any unaffiliated third party other than a billing or processing agent without the consumer's express authorization." We are hopeful that as the self-regulatory guidelines become more widely known and adopted, they will have a significant impact on industry practices and reduce consumer confusion and complaints about negative option marketing techniques. The guidelines are available at www.retailing.org.

Consumers Union

Publisher of Consumer Reports

Testimony of

Frank Torres
Legislative Counsel
Consumers Union

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

House Financial Services Committee

November 1, 2001

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Testimony of Frank Torres
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before the
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Chairman Bachus, Congresswoman Waters, members of the Committee, I appreciate the opportunity to testify today on behalf of Consumers Union[1].

We commend the members of this committee and your staffs for continuing the work of Congress during this time. We appreciate all that you do for America. All of us have many friends who work in these buildings. We care deeply about your safety and our thoughts continue to be with you.

Consumers Union, along with many other consumer organizations, has long been concerned about the practices of credit card companies and we are grateful for your scheduling of this hearing. We strongly support legislation introduced by Congressman LaFalce and others to help the American public by addressing many of the concerns we will be discussing today. We concur with the testimony offered by the U.S. Public Research Group and also support the legislation cited in their remarks.

Credit card companies continue to trick and trap unsuspecting consumers, despite complaints by consumers and state Attorneys General, actions brought by the Federal Trade Commission and the Comptroller of the Currency at the Treasury Department, regulations passed by the Federal Reserve Board, and record-setting fines for deceptive behavior.

Now, more than ever, consumers need the help of Congress. Americans answered mightily when called upon to help in the aftermath of the tragic events of September 11. Hundreds of millions of dollars have been donated to the relief effort. Schoolchildren collected their pennies. American consumers are being asked to bolster the economy by getting on with life, by spending, by going out to movies and restaurants.

[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

And while Americans are answering that call, various industry groups have lined up in Congress for taxpayer bailouts. We saw it from the airlines. We are seeing it from the insurance industry and lenders. There may be some legitimate need to look at some of those proposals that are in direct response to the September 11 events or possible future acts of terrorism. The House of Representatives has already passed an economic stimulus package that is designed to help businesses through tax cuts and other forms of fiscal relief.

But what is Congress doing to help the American family? There are ways Congress can put money directly back into consumers' pockets. And it wouldn't cost Congress, the federal government, or other taxpayers a dime. Congress wouldn't have dip into the surplus. It wouldn't require Congress to pass another tax break. Simply make credit card companies pass along the Federal Reserve Board's cut in interest rates to their customers. Help consumers out by dealing with the unfair setting of fees and punitive penalty rates charged by credit card companies. Take away the means by which the credit card industry engages in deceptive practices.

We are not implying that the credit card industry shouldn't make a profit. But businesses should profit because they are offering consumers a good product, because they are competing in the marketplace, and because they are better than the other guy. Congress should not allow credit card companies to profit because they have figured out how to cheat consumers.

Credit card companies have become increasingly dependent on fee income to bolster their profits. From 1995 to 1999, fee income increased by 158%. In 2000, fee income represented 25% of credit card companies' total income. Credit card companies are making their profits through late fees and penalty interest rates.

As a result, many credit card issuers have now pushed late payment fees as high as $35 and punitive rates to 24.99 percent. Companies charging that much include Fleet and Citibank. Credit card companies have no incentive to bring down their fees, cut rates, or lower the penalty charges.

In fact, since January 3, the Federal Reserve Board has cut the federal funds rate by four points in an effort to stimulate the economy. Mortgage interest rates have dropped. Interest rates for auto loans appear to have been lowered. Not so with the credit card industry – where rates have been either slow to fall to only a fraction of the Fed's cuts or not fallen at all.[2]

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[2] Some credit card issuers announced that they would waive late fees for cardholders affected by the September 11 events, according to CardTrack. Some companies, like Direct Merchants Credit Card Bank, announced it would waive fees for customers in directly affected areas that have payment due dates from September 11 to October 11. Bank One/First USA said they would sort through payments and determine who gets the fee waiver and who does not. Consumers should not face penalties for late payments caused by acts of terrorism.

Consumers with variable rate cards are hitting pre-set floors and therefore their interest rate no longer follows the Fed's rates to lower levels. Bankrate.com estimates that 25 percent of variable rate cards have floors. Many other consumers have fixed rate cards and will likely not benefit from the lowering of rates at all. It is estimated that about 45 percent of all bank credit cards carry fixed interest rates, which are unlikely to be cut.

Credit card rates have fallen by less than half the drop in general interest rates since January – meaning that many lenders are pocketing part or all of the difference as windfall profits. CardWeb, a research firm, estimates that the windfall for credit card companies amounts to at least $10 billion dollars. So while the Fed has made nine interest rate cuts this year to stimulate the economy, national credit card rates only dropped 1.59 percentage points below the December average interest rates. The bottom line is that the Fed's interest rate drops mean billions of dollars for credit card companies and little benefit for consumers trying to handle their credit card bills.

Some credit card companies play deceptive games with consumers who are merely trying to figure out how much the credit card will cost, what fees will be imposed, and what the penalties are. Credit card companies don't seem to want to tell consumers how much credit costs on their bill statements. Terms are buried in the fine print -- literally the fine print (at least until the Federal Reserve Board imposed a rule that increased the print size for a few key terms).

For example – how is a consumer supposed to act responsibly and make decisions when what a credit card company says isn't always what they mean? A spokesperson for Fleet explained how it works to *Consumer Reports* when she said that a fixed interest rate "doesn't mean it's fixed forever." In some cases, you don't even get all the fine print until you received the card. A case against Fleet concerned a "no annual fee" card that within months carried a $35 annual fee. Another case focused on a card promising a "fixed" annual percentage rate of 7.99 percent that soon rose to 10.5 percent. This is worse than Alice in Wonderland. At least there you had an idea that things were a little strange.

It is important to note that Fleet's changing the terms of the card didn't violate the Truth in Lending Act because the credit card agreement, like most, stated that the card companies could change the terms at any time. Finally, but perhaps coming as no real surprise, the Fleet customers who decided to cancel their cards found that the interest rate on the unpaid balance was a whopping 25 percent. That was in the cardholder agreement too.

Here's another example where consumers got duped. In May, the Office of the Comptroller of the Currency ordered Direct Merchants Credit Card Bank to pay restitution to 62,000 consumers. Direct Merchants was downsizing consumers by prominently marketing one package of credit card terms to consumers but then approving them for accounts with less favorable terms.

According to the OCC's consent decree, the solicitation package promised the consumer guaranteed approval with no processing fee. A disclosure made in the fine print on a separate insert stated that the consumer could be downsold to a card that required the consumer pay a $79 processing fee. If a consumer was downsold the consumer was told that he had been "upgraded" to a Titanium card and provided further information about the desirability of the Titanium card. The consumer would not be aware that he had to pay a processing fee until getting the periodic statement after the consumer had decided to accept the card.

Many lenders encourage minimum payments that do not pay down the loan. Currently, credit card statements, unlike mortgage loans and car loans, do not disclose the amortization rates or the total interest that will be paid if the cardholder makes only the minimum monthly payment. Using a typical minimum monthly payment rate on a credit card, it would take 34 years to pay off a $2,500 loan, and total payments would exceed 300 percent of the original principle. People don't understand how it works and the credit industry knows it. California recently passed a law that would require that credit card statement include how much a consumer actually owes in terms of principle and interest and how long it would take to pay off the debt if only the minimum payment was made.

Some in Congress and in the credit card industry say the answer lies in educating consumers. Even Chairman Greenspan says that financial education is important. And it is. But how much will financial literacy help consumers avoid these classic "bait and switch" scams?

If the practices of the credit card companies weren't enough for consumers to bear, the Federal Trade Commission estimates that consumer lose more than $40 billion a year to fraudulent telemarketers who make offers of worthless credit card protection services, guaranteed loans, and so-called protection from identity theft related to credit card use.

Usually, it is expected that a competitive marketplace would resolve some of these problems. The problem may be that the market is not competitive. The U.S. District Court in New York recently determined that practices of Visa and Mastercard are anticompetitive.

How does the lack of competition harm consumers? The court found that consumers may be denied the ability to choose from a variety of products that a financial institution could offer, may loose the benefit of increased innovation, and may not get the lower costs generally associated with a competitive marketplace.

Another way consumers may be impacted by the way the current credit card system operates is where merchants are forced to accept debit cards if they want to continue to accept credit cards. This requirement is the focus of a lawsuit filed by several major retailers. Those retailers say that the costs of taking the debit cards, which can be substantially higher than a card tied to a regional ATM network, get passed onto consumers. This provides a strong indication of the power gatekeepers to payment systems can wield in the marketplace.

Is there competition simply because consumers' mailboxes are routinely stuffed with credit card offers? The fact is that the sheer volume of offers alone cannot compensate for a lack of meaningful choice among credit card products and services available through a consumer's primary bank.

Besides, the actual interest rate a consumer may end up paying may have little to do with competitive pricing. The Federal Reserve Board reports that the pricing of interest rates is based on one of two factors, the cost of funds (typically tied directly to indexes that move with market rates), or borrower risk. Is the consumer really able to choose a card based on these pocketbook issues? And we've already seen how the rate isn't necessarily dependent of the cost of funds.

If credit card interest rates depend almost entirely on the credit risk and credit worthiness of the borrower, then there is another issue that Congress must address – the accuracy of credit reports and credit scores. Freddie Mac and Fannie Mae have determined that many consumers are paying more for their loans because their credit score is inaccurate. Despite the harsh ramifications if a consumer's credit score is inaccurate – higher fees, interest rates the inability to get a loan -- consumer advocates had to fight to get more details from the credit scoring companies about how that number is calculated. Until recently, a consumer couldn't even see his or her score.

Another common problem consumers face is that credit card issuers can change the terms of the deal at any time. And they have, finding new ways to generate fee income by raising fees and changing other payment terms such as due dates and grace periods. Another example occurred after a number of successful lawsuits initiated by consumers who were victims of fraudulent behavior by some credit card companies resulted in stiff penalties. The response from the industry wasn't a push to correct deceptive practices, but to amend their customer agreements and impose mandatory and binding arbitration thereby cutting off their customers' ability to take them to court.

Other credit industry practices include low introductory rates that turn out to be temporary. Consumers getting hit with permanent penalty interest rate increases because of a single late payment, or a late payment to another unrelated creditor. Grace periods that are shortened. Being late now may mean the payment center didn't get the consumer's check by ten o'clock in the morning the day it was due. The trend does not seem to be towards consumers getting a better product, just to more ways credit card companies have found to charge consumers more fees.

Another issue is the way that credit card companies target America's youth. According to bank regulatory agencies, including the Federal Reserve Board and the Federal Deposit Insurance Corporation, making loans without any regard for the borrower's ability to repay was "unsafe and unsound" and criticized such lending practices as "imprudent." Yet, credit card companies are on college campuses across the country signing up America's youth. Credit card companies often don't check if a student has the ability to repay and they typically don't require anyone to co-sign for the card. They used to, but don't anymore. Wouldn't it appear that the credit card companies' failure to check that a student has the ability to repay a loan is an unsafe and unsound practice?

The student loan corporation, Nellie Mae, said in a recent report that the increase in the number of students having a credit card includes students that would not have been given credit cards in past year, certainly not without a co-signer. The report also pointed to the need for counseling students at the front end -- before the student obtains a credit card. Nellie Mae found that:

- Some students unwittingly accumulate credit card debt, not consciously planning ahead whether they can afford to borrow that sum, and not aware of the actual finance charges they will pay over time.
- Having a card doesn't necessarily indicate knowledge about the ramifications of borrowing in general; nor does it show that the student has evaluated the benefit and costs of borrowing with a credit card vs. other types of financing.
- Without assistance, these students may not have the know-how to borrow wisely on the front end.

Many students end up dropping out of school under the weight of such debt. It is outrageous that the credit card companies' attitude has been that it is the student's fault, implying that the card companies themselves share no blame in what is a becoming a growing crisis on college campuses.

We cannot discuss issues related to the credit card industry without raising their collective effort to pass an onerous and lopsided bankruptcy bill. Consumers Union, as well as groups representing women and children, lower income consumers, labor, the victims of crimes, and the civil rights community, are concerned about the impact the credit card companies' version of bankruptcy reform will have on hardworking Americans.

Despite recent reports that there may be an attempt to conference on this bill, it would seem that with all that has happened the appropriate response would be – not now.

Congress could help all Americans avoid getting into trouble in the first place. Even before September 11 many Americans were facing job loss or downsizing, medical expenses they cannot afford to pay, and mounting bills. According the Federal Reserve Board studies new borrowers who are often riskier and more profitable for the credit industry as they get charged higher rates. But they often owe substantially more relative to their income, so even small drops in income can cause financial distress. These borrowers are more likely to work in relatively unskilled jobs. Delinquencies are higher among such workers, the report found, because their income is more closely tied to the business cycle. Thus, a mild economic slowdown can trigger a rise in bad debt.

We may not be able to predict with certainty which borrowers will be able to make it, but imposing high fees and punitive penalty interest rates, tricking and trapping consumers into paying more for credit cards, and not passing on interest rate cuts, does not help. It seems disingenuous for creditors to complain about the high number of bankruptcies when their behavior may push even more families over the edge.

Consumers Union and other consumer and privacy advocates remain concerned about the ability of financial institutions, including credit card companies, to share sensitive financial information about their customers. The shortcomings of the privacy provisions of the Gramm Leach Bliley Act have been widely discussed. Many privacy notices sent out to customers are virtually unreadable. Many consumers likely gave up and tossed the notices out or didn't understand how to respond. In reality, the law didn't give consumers much of a choice anyway. Even if a consumer opted out, the financial institution could share that customer's data anyway. Privacy and security concerns about consumers' personal financial information will remain until Congress acts. Identity theft continues to grow according to recent estimates by the Federal Trade Commission. Oftentimes the fraud occurs when the criminal obtains a credit card in someone else's name.

Unfair business practices that have gone unchecked for so long amount to an unfair tax on consumers. With the rise in credit card profits and mounting evidence of deceptive practices and improper fees that unfairly take money out of people's pockets, Americans deserve their own bail-in package.

You could save every consumer perhaps thousands of dollars by addressing even a few of the practices of the credit card industry. That's real money for American consumers and a welcome stimulus to the economy.

We appreciate the Committee's willingness to hold hearings on this issue

Testimony of the

U.S. Public Interest Research Group

Edmund Mierzwinski
Consumer Program Director

Oversight Hearing On
Abusive Credit Card Industry Practices

Before the Subcommittee on
Financial Institutions and Consumer Credit

The Honorable Spencer Bachus, Chairman

House Financial Services Committee
U.S. House of Representatives

1 Nov 2001

TESTIMONY OF THE U.S. PUBLIC INTEREST RESEARCH GROUP (U.S. PIRG) ON ABUSIVE CREDIT CARD INDUSTRY PRACTICES

Chairman Bachus, Ranking Member Waters, members of the committee: Thank you for the opportunity to offer U.S. PIRG's views on abusive credit card industry practices. We commend you for having this timely hearing. I am Edmund Mierzwinski, Consumer Program Director, for U.S. PIRG. As you know, U.S. PIRG serves as the national lobbying office for state Public Interest Research Groups. PIRGs are non-profit, non-partisan public interest advocacy organizations with offices around the country.

(1) SUMMARY:

The credit card industry, in efforts to increase profitability above already substantial levels, is engaging in a wide number of unfair, anti-consumer practices. These practices include the following:

- deceptive telephone and direct mail solicitation to existing credit card customers – ranging from misleading teaser rates to add-ons such as "freeze protection;"
- increased use of unfair penalty interest rates ranging as high as 30% APR for consumers who allegedly miss even one payment to <u>any</u> creditor, not merely to the credit card company;
- higher late payment fees, often levied in dubious circumstances, even when consumers mail payments 10-14 days in advance;
- aggressive and deceptive marketing to new customer segments, such as college students and persons with poor credit history;
- partnerships with telemarketers making deceptive pitches for over-priced credit life insurance, roadside assistance and other unnecessary card add-ons;
- the increased use of unfair, pre-dispute mandatory arbitration as a term in credit card contracts, to prevent consumers from exercising their full rights in court;
- the failure of the industry to pass along the benefits of the Federal Reserve Board's interest rate cuts intended to provide economic stimulus, through the use of unfair floors in credit card contracts.

These views are not merely our own. The very worst of the industry's excesses have resulted in increased regulatory, legislative and legal scrutiny:

- In 2000, the San Francisco District Attorney and Office of the Comptroller of the Currency (OCC) imposed a minimum of $300 million in civil penalties and a restitution order against Providian for deceptive marketing of mandatory credit or freeze protection, a form of credit life insurance, and other violations. The OCC, not generally known for hyperbole in defense of the consumer, said the following: "We found that Providian engaged in a variety of unfair and deceptive practices that enriched the bank while harming literally hundreds of thousands of its customers[i]."
- In 2001, the OCC imposed multi-million dollar penalties and a restitution order against Direct Merchants' Bank its practice of "'downselling' consumers by prominently marketing to consumers one package of credit card terms, but then approving those consumers only for

accounts with less favorable terms, and touting the approved account in a fashion designed to mislead the customer about the fact he or she had been 'downsold'[ii]."

- Since 1999, the Minnesota Attorney General and other states have settled multi-million dollar claims against U.S. Bank for its practice of allowing telemarketers access to its credit card customer records for the purpose of deceptively marketing add-on products including credit life insurance, roadside assistance packages, and other gimmickry billed to consumers who did not even give their credit card numbers and had no knowledge that they had allegedly placed orders or would be billed for any product.
- Several private class action lawsuits have been settled recently against other large banks for abusive practices, such as charging consumers late fees, even when they pay on time.
- Numerous colleges and universities, as Doctor Manning will indicate in his testimony, have banned or strictly regulated the marketing of credit cards on campuses, to address widespread complaints about tawdry practices.

(2) POLICY RECOMMENDATIONS OF U.S. PIRG TO ADDRESS ABUSIVE CREDIT CARD PRACTICES:

- **Moratorium on Late Fee Penalties:** In response to uncertainty over mail delivery following events related to the 9/11 terrorist attacks, enact legislation codifying the OCC's 12 September "encouragement" that banks voluntarily work with debtors who may pay bills late, especially if due to mail disruption. (See OCC Press release NR-2001-79).

  Specifically, we urge Congress to enact legislation placing a nationwide moratorium on the use of late payment information in credit scores or credit decisions by credit card companies for the period September-December 2001. Over this time, late payment fees should be suspended and late payments should not be used for the purpose of raising interest rates or using risk-pricing to make a consumer eligible for a less-favorable offer.
- **Prohibit Deceptive Practices:** Enact legislation (HR 1060) introduced by Rep. LaFalce and others to prohibit numerous deceptive practices, including a prohibition on raising a credit card interest rate or taking other negative action based on information unrelated to the consumer's account. We have received numerous complaints (over the last year) that banks are reviewing credit reports of existing customers and raising rates due to one or two late payments to any creditor, even if the consumer's payments to the credit card issuer are timely and the account is in good standing. This bill would also address numerous other deceptive practices, include what the Minnesota Attorney General calls "pre-acquired account telemarketing," such as in the U.S. Bank case. In our view, the provisions of Gramm-Leach-Bliley dealing with encrypted credit card numbers do not solve this problem[iii].
- **Cap Interest Rates:** Cap credit card interest rates for two years, as Rep. Sandlin has proposed in HR 3125 (12% APR) and HR 3126 (5.5% above WSJ prime). These laudatory bills should be amended to make explicit that penalty interest rates would also not be allowed.
- **Improve Disclosures:** Enact the omnibus LaFalce bill (HR 1052) calling for better credit card disclosures, banning unfair practices and restricting certain college student marketing. A similar, overlapping bill with positive features is Rep. Roybal-Allard's proposal (HR 2032).

- **Require A Minimum 30 Days to Pay Credit Card Bills and Base Late Payments On Postmarks:** Enact legislation requiring a minimum 30 days to pay a credit card bill and relating an on-time payment to the postmark. This year, legislation requiring a minimum 30 days for bill payment has been filed by Rep. Pascrell (HR 296). In the past "not late if postmarked by due date" bills have been filed by Rep. Hooley, (HR 3477, 1999) and former Rep. Andy Jacobs, (HR 1537, 1995) and current Rep. John McHugh, (HR 1963, also in 1995).
- **Ban Mandatory Pre-Dispute Arbitration:** Enact legislation proposed in 1999 by Rep. Gutierrez (HR 2258) banning pre-dispute mandatory arbitration in consumer contracts, including credit cards.

In addition, U.S. PIRG concurs with the strong recommendation today of Consumers Union that the Congress reject unnecessary, over-reaching, unfair bankruptcy reform aggressively sought by the credit card industry in this Congress and currently in conference committee. In addition to the bill's general manifest harshness and its intended elimination of a critical safety net during uncertain economic times, the bill's nominal credit card disclosures are deficient and unacceptable, as Consumers Union points out in detail.

(3) ABUSIVE CREDIT CARD INDUSTRY PRACTICES: RESULTS OF A PIRG SURVEY

In April 2001, the PIRG's released a major report, *The Credit Card Trap: How To Spot It, How To Avoid It.* The report included a detailed study of the worst credit card practices and along with a detailed fact sheet called the "Road Map To Avoiding Credit Card Hazards," <http://www.truthaboutcredit.org/roadmap.pdf>, is available on the Internet at <http://www.truthaboutcredit.org>. Without objection, I would like to enter the roadmap into the record of the hearing as an appendix to my testimony today.

The following are the key findings of a survey of 100 credit card offers conducted by the state PIRGs in summer 2000 and included in "The Credit Card Trap[iv]."

(A) Key Findings of PIRG's "The Credit Card Trap" Survey

I. Terms and Conditions Are Worsening

In a survey of 100 credit card offers, the State PIRGs found that:

- **The average penalty annual percentage rate (APR) was 22.84%, eight points higher than the average APR for purchases, and is triggered by as little as one late payment or a late payment to another creditor.**

The average penalty APR (the APR for accounts that are delinquent) was 22.84%, nearly eight percentage points higher than the average APR for purchases.

That increase is especially concerning because credit card companies may charge the penalty APR if a single payment is even one day late or arrives later than a specified time on the due date. Credit card companies may also charge a penalty APR if the creditor finds that there is a problem with a cardholder's payment pattern on other debts. Once a penalty APR is assessed, it may remain in place permanently or for a particular amount of time.

- **The average late payment fee was $27.61, and fees ranged from $15–$35.**

All cards surveyed assessed late payment fees, which ranged from $15 to $35 and averaged $27.61. Consumers are paying more and credit card companies are reaping more profit from late fee income than ever before. Income from late fees has risen for three reasons:

(1) the average late fee has more than doubled since 1992, when the average was $12.53, and fee amounts continue to grow;
(2) companies have decreased the amount of time between when a bill is mailed and payment is due; and
(3) nearly two-thirds of companies have eliminated leniency periods, the time after a payment's due date before a late fee is assessed.

- **The average grace period was 22.6 days. Five cards had no grace period at all.**

The average grace period was 22.6 days. Only one card surveyed had a grace period of 30 days, and five (all from the same company) had no grace period at all. Grace periods are rapidly decreasing in length as credit card companies realize that shorter grace periods bring in more profit. In addition, a grace period usually does not apply if a balance is carried from month to month.

- **The average over-the-limit fee was $27.61, and fees ranged from $15–$35.**

All 100 cards surveyed charged over-the-limit fees to cardholders who exceeded their credit limits by as little as one dollar. Those fees ranged from $15 to $35, and averaged $27.61. The State PIRGs' survey found only one company that charged a fee of less than $20. In addition, a punitive APR increase often accompanies the assessment of an over-the-limit fee, worsening the financial impact on consumers.

- **Minimum payments are decreasing, bringing in more money for credit card companies.**

Credit card companies are raising profits by lowering minimum payments from the former industry standard of 5% of the unpaid balance to as low as 2%. As a result, consumers who pay only the minimum each billing cycle stay in debt longer and pay more interest.

B. Marketing Practices Are Misleading and Deceptive

☐ **Credit card companies use low, short-term "teaser rate" introductory APRs to mask higher regular APRs. The average introductory APR was 4.13%, which jumped 264% to an average regular APR of 15.04%.**

The introductory APR is one of the primary tools used to market a card, and it usually appears in large print on the offer and envelope. Of the 100 card offers surveyed, 57 advertised a low average introductory APR of 4.13%. Within an average of 6.8 months, the regular APR shot up

264% to an average regular APR of 15.04%. The post-introductory APR, as well as the length of the introductory period, were not prominently disclosed.

- **Important information is disclosed only in the fine print of the offer.**
  For example, the fine print of most offers states that if an applicant does not qualify for the offered card, s/he will receive a lower-grade card, which usually has a higher APR and punitive fees (a practice called "bait and switch"). The fine print is easy to overlook, and as a result, a consumer may receive a card that s/he did not want.

- **Free does not mean free.**
  The "free" offers that are advertised with many cards are not usually as impressive as they appear. Most have significant restrictions or hidden costs, such as enrollment fees or expiration dates.

- **Companies are failing to disclose the actual APRs of cards.**
  Increasingly, credit card companies are quoting a range of APRs in offers rather than a specific APR, a practice called "tiered" or "risk-based" pricing. These ranges are frequently so wide as to be utterly useless to consumers. For example, Providian National Bank's Aria card has a range of 7.99% (for "preferred" customers) to 20.24%. As a result, applicants don't know what APRs they will get until they receive their cards.

- **"Fixed" rates may not be fixed at all.**
  Credit card companies play on consumers' common misconception of the term "fixed rate." Though companies imply that a fixed rate will not increase for the life of the card, companies actually may increase fixed rates with as little as 15 days notice to cardholders.

- **Fine Print**
  Fees for cash advances, balance transfers, and quasi–cash transactions such as the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print, where consumers can easily miss them. Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount.

C. Marketing to College Students is Too Aggressive

Having saturated the working adult population with credit card offers, credit card companies are now banking on a new market: college students. Under regular credit criteria, many students would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they grow older. Nellie Mae, the student loan agency, found that 78% of undergraduate students had credit cards in 2000. Credit card companies have moved on campus to lure college students into obtaining cards. Their aggressive marketing, coupled with students' lack of financial experience or education, leads many students into serious debt.

The State PIRGs surveyed 460 college students within the first month of either the fall or spring semester of 2000–2001. The key findings include:

- Two-thirds of college students surveyed had at least one credit card. The average college student had 1.67 credit cards.
- 50% of students obtained their cards through the mail, 15% at an on-campus table, and 10% over the phone.
- 50% of students with cards always pay their balances in full, 36% sometimes do, and 14% never do.
- 48% of students with one or more cards have paid a late fee, and 7% have had a card cancelled due to missed or late payments.
- 58% of students report seeing on-campus credit card marketing tables for a total of two or more days within the first two months of the semester. Twenty–five percent report seeing on-campus tables more than five days.
- One-third have applied for a credit card at an on-campus table. Of these, 80% cite free gifts as a reason for applying.
- Only 19% of students are certain that their schools have resources on the responsible use of credit. Three out of four of these students (76%) have never used these resources.

(4) BRIEF PROFILE OF THE CREDIT CARD INDUSTRY:

Though interest rates fell sharply in the early 1990s after twenty years of relative stability, the cost of credit has risen dramatically since then.[v]

In its 1999 *Annual Report to Congress* on credit card pricing, the Federal Reserve Board acknowledged that "credit card pricing . . . involves other elements, including annual fees, fees for cash advances, rebates, minimum finance charges, over-the-limit fees, and late payment charges."[vi] The report also notes that, in the past, card issuers offered one interest rate for all customers. In recent years, however, issuers have begun to offer a range of interest rates, with the specific rate offered to a consumer dependent on that consumer's particular credit risk and usage patterns. Finally, the report notes that issuers have tried to make their cards more attractive by offering low introductory rates, especially on balance transfers, and by offering affinity cards, such as cards with airline mileage programs or cash rebates.[vii]

Credit card companies have increased the cost of credit by decreasing cardholders' minimum monthly payments, increasing interest rates, and piling on enormous fees. In recent years, credit card companies have decreased the minimum percentage of the balance that cardholders must pay in order to remain in good standing. Today, most companies require a minimum monthly payment of only 2% or 3% of the outstanding balance. As a result, cardholders who choose to pay only the minimum each month take longer to pay off their balances, paying more interest in the process.

Credit card companies' profits nearly tripled from 1995 to 1999, jumping from $7.3 billion to $20 billion. The industry's widespread adoption of costly terms and conditions helped lead to this massive increase in profits. Some of the newest conditions companies have imposed on consumers include:

- increased late payment fees,
- significant annual percentage rate (APR) increases after only one or two late payments,

- increases in a consumer's APR when her standing with other creditors declines,
- increased APRs for cash advances, decreased grace periods, and
- decreased minimum monthly payments.

In 2000, fee income accounted for 25% of credit card companies' total income, and between 1995 and 1999, total fee income increased by 158%, from $8.3 billion to $21.4 billion.[viii]

The rising cost of credit is contributing to an increase in average personal debt. In 2000, the average credit card debt for Americans who carry a balance reached $5610, and increase of nearly one-third since 1995.[ix]

Consumers file for bankruptcy to bring enormous debts under control. The typical Chapter 7 bankruptcy filer has high credit card debts-in 1996, $17,544 in credit card debt and an annual after-tax income of $19,800.[x] From 1996-2000, revolving debt, such as that incurred by the use of credit cards, accounted for about 20% of total household debt, according to the Federal Reserve.

(5) DETAILED DISCUSSION OF SOME OF THE WORST DOCUMENTED ABUSES:

Providian Bank:

In June 2000, the San Francisco District Attorney and OCC imposed civil penalties and restitution requirements of a minimum of $300 million on Providian Bank. Some observers will say that Providian's recent well-publicized market value crash proves that it was aberrant and flew too close to the sun, therefore nothing more needs to be done. In our view, Providian's recent charge-off problems and subsequent stock market crash are due to its business model of targeting risky applicants, but its credit card marketing practices are not atypical of an industry that still needs to be reined in.

According to the OCC Fact Sheet on the Providian settlement, Providian claimed consumers were guaranteed better rates than they were actually offered and were coerced into purchasing mandatory credit protection insurance for $156/year on cards that were otherwise marketed as free of annual fees. The credit protection product also had numerous loopholes and exceptions, detailed in the footnoted fact sheet.

> In marketing this product, the bank did not adequately disclose that, although there was technically no annual fee, the consumer was required to purchase Credit Protection at $156 a year. If, after receiving a bill for the Credit Protection, the consumer complained, the bank informed the consumer that the Credit Protection was mandatory. If the consumer insisted that they did not want the Credit Protection, the bank informed the consumer that the only alternative was for the consumer to pay an Annual Fee. Thus, in order for the consumer to receive a card with no Annual Fee, the consumer had to pay for even more expensive Credit Protection.[xi]

Direct Merchants Bank:

According to the OCC Fact Sheet on its settlement with Direct Merchants Bank, imposing civil penalties of over $3 million, many consumers were switched from a favorable to a less favorable, sub-prime card: "In some mailings, over 50% of consumers who responded were downsold and required to pay the $79 processing fee[xii]."

U.S. Bank:

In 1999, U.S. Bank entered a multi-million settlement with the Attorney General of Minnesota over its practice of allowing a telemarketer, Memberworks, to contact credit card holders and pitch a series of products to them on a negative option basis. The bank reportedly received a multi-million dollar commission. Consumers who thought they were receiving "free trial offers" in fact would have their credit cards billed unless they called and cancelled, although the consumers themselves had not given the telemarketer their account number—U.S. Bank had.

As the Minnesota Attorney General points out in a subsequent complaint against a mortgage company, Fleet Bank, the practice of billing consumers who have not provided their account numbers is a troubling one that changes the whole dynamic of selling.[xiii] The Attorney General, Mike Hatch, describes the practice as "pre-acquired account telemarketing."

> Other than a cash purchase, providing a signed instrument or a credit card account number is a readily recognizable means for a consumer to signal assent to a telemarketing deal. Pre-acquired account telemarketing removes these short-hand methods for the consumer to control when he or she has agreed to a purchase. The telemarketer with a pre-acquired account turns this process on its head. Fleet not only provides its telemarketing partners with the ability to charge the Fleet customer's mortgage account, but Fleet allows the telemarketing partner to decide whether the consumer actually consented. For many consumers, withholding their credit card account number or signature from the telemarketer is their ultimate defense against unwanted charges from telemarketing calls. Fleet's sales practices remove this defense.[xiv]

First USA Bank

In 1999, according to a Freedom of Information request filed by U.S. PIRG with the OCC, the agency received as many complaints against First USA as it did against the next nine most-complained about credit card issuers combined. Although, as far as we know, the OCC did not pursue civil penalties against or impose sanctions against First USA, several private class actions were also recently brought against the company. Since 1999, many of the complaints we have received and that the media reported on concerned First USA allegedly billing consumers late who claimed that they had paid on time[xv]. Other cases have alleged that the company engages in bait-and-switch tactics on introductory interest rates.[xvi]

(6) CONCLUSION

Due to the limited time available, I have had not been able to touch on numerous other issues we have with the credit card industry. In addition to its unfair marketing and billing practices, its sloppy record-keeping and credit application decision-making also results, for example, in increased identity theft. Consumers who are victims of identity theft may spend years clearing their good names[xvii].

We urge the committee to review U.S. PIRG commends the committee for holding this important hearing. We hope that we have provided you with adequate information to support the need for action by the Congress to rein in the credit card industry's most unfair and abusive practices.

ENDNOTES

[i]June 28, 2000, Statement of Comptroller of the Currency John D. Hawke, Jr.
[ii] Fact Sheet Regarding Settlement Between the OCC and Direct Merchants Bank, 3 May 2001
[iii] For additional information and a detailed discussion, see my testimony before the Committee on Commerce's Subcommittee on Commerce, Trade and Consumer Protection <http://www.house.gov/commerce/hearings/04032001-154/Mierzwinski242.htm> 3 April 2001.
[iv] See <http://www.truthaboutcredit.org>
[v] "The Profitability of Credit Card Operations of Depository Institutions: An Annual Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988." June 1999.
[vi] Ibid.
[vii] Ibid.
[viii]"Fee Income." July 2000. www.cardweb.com/cardtrak/pastissues/july00.html.
[ix] "Many Americans Charge Wisely, but More Carry Deeper Debt." Lucy Lazarony, www.bankrate.com.
[x]"Recent Trends in Bank Credit Card Marketing and Indebtedness." Stephen Brobeck , Consumer Federation of America, July 1998.
[xi] OCC's Providian Fact Sheet, http://www.occ.treas.gov/ftp/release/2000%2D49d.doc 28 June 2000
[xii] OCC's Direct Merchant's Fact Sheet, <http://www.occ.treas.gov/interp/ea/fact%20sheet2001%2D24.doc> 3 May 2001.
[xiii] For additional information and a detailed discussion, see my testimony before the Committee on Commerce's Subcommittee on Commerce, Trade and Consumer Protection <http://www.house.gov/commerce/hearings/04032001-154/Mierzwinski242.htm> 3 April 2001.
[xiv] 28 December 2000, Complaint of State of Minnesota vs. Fleet Mortgage, see <http://www.ag.state.mn.us/consumer/news/pr/Comp_Fleet_122800.html>
[xv] See transcript of ABC Nightline, with Ted Koppel, 31 August 1999.
[xvi] See, eg, <http://www.seattleclassaction.com/achievmt.htm#first%20usa> where on 15 June 2001 a settlement for "$50 million plus over $36 million in benefits from other settlement related offers," by the firm of Keller Rohrback.
[xvii] See "Nowhere To Turn: A Survey of Identity Theft Victims," CALPIRG, USPIRG and the Privacy Rights Clearinghouse, May 2000, for a detailed summary of PIRG's platform on identity theft. <http://www.calpirg.org/consumer/privacy/idtheft2000/idtheft2000.pdf>

A Road Map to Avoiding Credit Card Hazards

Credit card companies are flooding us with card solicitations, deceiving us with misleading offer terms, and gouging us with higher-than-ever fees. As a result, consumers are sinking further into high-cost credit card debt.

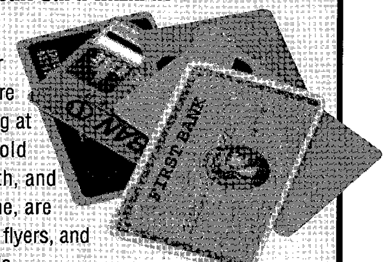
What should you be on the lookout for?

How can you avoid being ripped off?

MASSPIRG
EDUCATION FUND
Telephone 617-292-4800

www.truthaboutcredit.org

A Road Map to Avoiding Credit Card Hazards



As credit card companies intensify their marketing campaigns to boost profits, more and more glossy credit card offers are coming at us fast and furious. The average household receives eight credit card offers each month, and students, who often have no regular income, are encouraged several times a week by posters, flyers, and on-campus marketers to apply for credit cards.

At the same time, credit card companies are charging interest rates as high as 40% per year. Consumers are subject to a host of unfair and deceptive terms and conditions, saddled with enormous fees, and encouraged by credit card companies to make low minimum payments so that the companies can earn more money in the form of interest. As a result, the average credit card debt for Americans who carry balances reached an all-time high of $5,610 in 2000, an increase of one-third since 1995.

As consumers struggle, credit card companies such as Providian and First USA are making bigger profits than ever. Between 1995 and 1999, thanks in part to aggressive marketing and misleading practices, companies' profits nearly tripled, jumping from $7.3 billion to $20 billion.

Accident Ahead: 10 Credit Card Traps

1. More Late Fees

Credit card companies are reaping more profit from late fee income than ever before, for three reasons: (1) the average late fee more than doubled between 1992 and 2000, from $12.53 to $27.61, (2) companies have decreased the amount of time between when they mail a bill and when payment is due, and (3) nearly two-thirds of companies have eliminated leniency periods, (the time after a payment's due date before a late fee is assessed).

2. Higher Over-the-Limit Fees

In 2000, only one card charged a fee of less than $20 to consumers who had exceeded their credit limits. The highest fee was $35. In contrast, a 1995 survey found only one bank that charged a fee of $20 or more. Many companies assess this fee to cardholders who exceed their limits by as little as $1.

3. Hidden Transaction Fees

Fees for cash advances, balance transfers, and quasi-cash transactions like the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print where consumers can easily miss them.

Currently, 55 to 60 million households (50-60% of all households in the United States) carry credit card balances. The average household carries a balance of $7000 and pays more than $1000 per year in interest and fees.

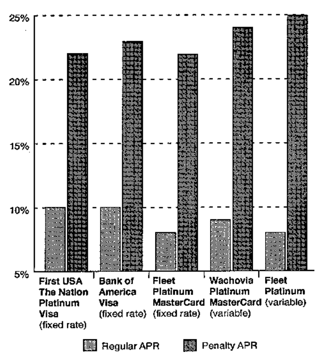
(Source: Stephen Brobeck, Consumer Federation of America)

Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount. For example, if XCard has a transaction fee of 3% and a minimum of $10, a cardholder who receives a $50 cash advance will be charged the minimum, $10, which amounts to an actual transaction fee of 20%.

4. Punitive Annual Percentage Rate (APR) Increases

The average penalty APR—a higher interest rate triggered by a late or missed payment—is nearly eight percentage points higher than the average regular (non-penalty, non-introductory) APR. In 1998, by contrast, penalty APRs were an average of 4.5 percentage points higher than regular APRs.

Punitive APRs: How One Late Payment Can Cost You



Fleet Platinum MasterCard (variable rate)*

Penalty APR is 16.91 percentage points higher than regular APR

	Regular APR (7.99%)	Penalty APR (24.90%)
Total Interest Paid:	$466.73	$3,314.87
Time to Pay Off Balance:	84 months	169 months

**calculations based on a balance of $2000 and 3% monthly payments*

5. Declining Grace Periods

While grace periods (the time during which a transaction does not accrue interest) historically were a full month long, they now average 23 days. Some cards have no grace periods at all.

6. Introductory APRs

Fifty-seven percent of card offers advertised a low introductory APR. The average introductory APR was 4.13% and lasted an average of 6.8 months. But credit card companies use low, short-term introductory APRs to mask regular APRs that are an average of 264% higher. These sharp rate increases are not prominently disclosed.

7. Low Minimum Payments

Low minimum monthly payments are designed to sound attractive to consumers, but they encourage cardholders to pay more in finance charges as the length of time required to pay off a balance increases significantly. Credit card companies have decreased minimum payments in recent years from the historic industry standard of 5% to a current standard of 2% to 3%.

Always Pay More than the Minimum: It Saves You Money

Beginning Balance	APR*	Monthly Payments	Total Interest Paid	Months to Pay Off Balance
$2,000	15.04%	2%	$2,205.63	169 (14 yrs.)
$2,000	15.04%	5%	$589.74	65 (5.5 yrs.)
$2,000	15.04%	10%	$269.31	36 (3 yrs.)

**the APR of 15.04% is the average non-introductory, non-penalty APR found in the State PIRGs' survey of 100 credit card offers. NOTE: Results based on $20 minimum payment or the percent, whichever is greater.*

8. "Fixed" APR

Despite their name, so-called "fixed" interest rates can be raised with as little as 15 days notice to cardholders.

9. "Bait and Switch" Credit Card Offers

Direct mail credit card offers generally advertise the premium card the bank has to offer, yet the fine print includes the caveat that the company can substitute a lower-grade, non-premium card if the applicant does not qualify for the premium card. The lower-grade card costs more and offers less attractive terms, facts which are rarely mentioned in the official disclosures of the offer.

10. Tiered Pricing
This new, anti-consumer practice is catching on quickly with credit card companies. In an offer, the company quotes a meaninglessly-wide range of possible APRs: Providian's Aria card, for example, quotes a range of 7.99% to 20.24%. The company then assigns an APR to each applicant once the card is issued, based on the applicant's credit history. Consumers are thus being denied the right to know the terms of a credit card before they accept an offer.

Consumers at the Wheel: Navigating Credit Card Offers

1. Shop around before accepting a credit card offer. Terms and conditions vary widely, so it's important to compare offers–for example, regular APRs range from 7.99% to 30.25%. Key fees and terms to compare:

- **regular (non-introductory) APR**: look for APRs near or below 15.04%
- **grace period:** at least 25 days
- **late payment fee:** no higher than $20
- **annual fee:** look for cards with no annual fee (most do not have annual fees)
- **penalty APR:** look for cards that don't assess penalty APRs, or if unavoidable, penalty APRs no higher than 20% and in place for a limited period of time only (for example, until two consecutive payments are made on time)

2. Read the fine print–disclosure charts and surrounding text–carefully and thoroughly before accepting a card. Many punitive fees are stated only in the fine print below the disclosure chart.

3. Carry only one or two major credit cards, and avoid using the full available credit line. Remember that credit card purchases are more expensive than cash or check purchases once interest and other fees are included. Use credit cards sparingly and wisely.

4. Pay off all balances in full every billing period, or pay as large a portion of the remaining balance as possible, making the largest payments toward the card with the highest interest rate. Always pay more than the minimum, if possible!

5. Reduce the number of direct mail credit card solicitations you receive by calling 1-888-5-OPTOUT. This will remove your name from pre-screening lists at the three major credit bureaus.

6. Seek credit counseling as soon as financial problems arise. To locate a free or low-cost credit counseling agency near you, call 1-800-388-2227 or visit www.nfcc.org. For one-on-one counseling over the phone, call 1-800-680-DEBT, or visit www.myvesta.org on the Internet.

7. Check your credit reports at least once a year for errors. Correct any errors immediately. Consumers in CO, GA, MA, MD, NJ, and VT are entitled to one free report per bureau per year; consumers in other states may have to pay up to $8 per report. To receive copies, call:

Equifax	1-800-685-1111
Experian	1-888-397-3742
TransUnion	1-800-888-4213

8. If you believe you are the victim of unfair interest rate charges, late fees or other penalties, or deceptive marketing, and the credit card company fails to address your complaint, file complaints with your state Attorney General's office and the national Office of the Comptroller of the Currency:

- **visit:** www.occ.treas.gov/customer.htm
- **call:** 1-800-613-6743, (M-F 9am-3:30pm CST)
- **e-mail:** Customer.Assistance@occ.treas.gov
- **fax:** 1-713-336-4301 or;
- **mail:** Customer Assistance Group
  1301 McKinney Street, Suite 3710
  Houston, Texas 77010

9. Use the credit calculator, available online at www.truthaboutcredit.org, to calculate how much you need to pay each month to pay off your balance within the time frame you've specified. The calculator can also tell you how long it will take to pay off your balance if you continue to pay the same amount each month.

10. Know your financial means and limitations, and don't spend beyond your means. Create a budget that takes into account your average credit card payments each month, and stick to it.

STOP Road Signs: Terms You Should Know

Annual Percentage Rate (APR): The amount of interest assessed on an outstanding credit card balance. For billing purposes, the APR is usually divided into periodic (monthly or daily) rates. A variable APR, often referred to as "prime + x%," is tied to an economic market index such as the Prime Rate; thus it fluctuates with the economy. A fixed APR does not fluctuate with the market; rather, it is set by the credit card company. The company can change it at any time with as little as 15 days notice to cardholders.

Penalty APR: A much higher, punitive interest rate that credit card companies may apply to cardholders who have exceeded their credit limits, made one or more late payments, or are otherwise in "bad standing." Penalty APRs are, on average, about 52% higher than regular APRs.

Credit Limit (or Line): The maximum, cumulative amount of money a consumer may borrow from a credit card company. Credit limits are set based on a consumer's credit history; however, this does not necessarily mean that the limit is one that the consumer can afford.

"Pre-Approved": This term is misleading and does not mean that a consumer is guaranteed to receive the card for which s/he has applied, or any card at all. It merely means that the consumer was chosen to receive the offer because s/he met some initial criteria of creditworthiness.

Grace Period: The time during which a transaction does not accrue interest. Grace periods range from 0-30 days, with an average of 23 days, and they often apply only to purchases, not cash advances or other transactions. On most cards, grace periods only apply if the previous month's balance is paid in full and on time.

Transaction Fee: Cardholders are nearly always assessed additional fees for transactions other than purchases (such as cash advances). The fee is usually a percentage of the transaction, but a minimum fee may apply. Transaction fees may or may not be capped.

Quasi-Cash Transaction: A transaction similar to cash, such as the purchase of lottery tickets or betting chips. These are usually subject to transaction fees.

Cash Advance: An immediate cash loan from a consumer's credit card account. Cash advances may carry a higher APR than purchases, and often are assessed transaction fees. Grace periods may not apply to cash advances.

Balance Transfer: At a cardholder's request, credit card company A will pay the balance the cardholder has with company B, and the balance will then be put onto the cardholder's account with company A. Consumers usually transfer balances when applying for a new card, to take advantage of low introductory APRs. Balance transfers usually incur transaction fees.

Schumer Box/Disclosure Chart: The disclosure chart contains the most important information of the offer (although not all important information is included in it). By law, the disclosure chart must contain:

1. the actual APR (that is, what the APR will be once the introductory period ends)
2. the formula for the APR, if the rate is variable
3. the length of the grace period
4. the amount of the annual fee, if any
5. the minimum finance charge
6. any transaction fees (for example, fees for cash advances)
7. the method of computing the purchase balance for each billing period
8. late payment fees, and default or delinquency fees
9. over-the-limit fees

Methods of Computing Balances: Methods used vary widely and have a significant effect on the cost of credit. There are three main methods:

1. Average Daily Balance. This is the most common computation method. The outstanding balances for each day in the billing cycle are added, and this total is divided by the number of days in the billing cycle. New purchases may or may not be added, depending on the terms of the card. If the terms state that new purchases are included, purchases made during the billing cycle will raise a cardholder's balance and may increase the finance charge. Once the average daily balance is calculated, interest is assessed each day at the daily rate, which is the annual percentage rate divided by 365.

2. Adjusted Balance. Payments or credits that are received during the current billing period are subtracted from the balance at the beginning of the billing cycle. New purchases are not included in the calculations. For example, if a cardholder's beginning balance was $2000, and s/he made a payment of $500 during the billing period, s/he would only be charged interest on the remaining $1500. This is generally the most consumer-friendly computation method.

3. Two-Cycle Balance. To obtain this balance, credit card companies add together the average daily balances for the current and the previous billing cycles. The average daily balances for the current billing period may or may not include new purchases. The two-cycle balance method is the least consumer-friendly method of balance computation.

Secured Credit Card: This type of credit card is linked to a bank account, allowing a credit card company to deduct payment if the cardholder fails to pay. To obtain a secured card, a consumer must deposit an amount of money equal to the credit limit of the card into a bank account. This account is separate from any other accounts the consumer may have.

Debit Card: Debit cards are not credit cards; rather, they deduct money directly from the cardholder's bank account whenever a transaction is made with the card. Consumer protections guaranteed by law to credit card users often do not apply when a debit card is used.

SCHOOL

School Zone: College Students and Credit Cards

Having saturated the working adult population with credit card offers, credit card companies are now banking on a new market: college students. Under regular credit criteria, many students would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they get older. Nellie Mae, the student loan agency, found that 78% of college students had credit cards in 2000. Credit card companies have moved on campus to lure college students into obtaining cards. Their aggressive marketing, coupled with students' lack of financial experience or education, leads many students into serious debt.

Warning Signals

- Undergraduates with credit cards carried an average balance of $2,748 in 2000. (Source: Nellie Mae)
- Half of all college students with credit cards don't pay their balances in full every month.
- 58% of college students reported seeing on-campus credit card marketing tables for two or more days within a one month period at the beginning of the semester.
- On a test of personal finance skills administered to high school seniors, students averaged a score of 57%, an F on any grading scale. Only 5% of the seniors scored a C or better. (Source: Jump Start, www.jumpstart.org)

WRONG WAY

"Children, dogs, cats, and moose are getting credit cards."

Alan Greenspan, Federal Reserve Chairman, in a 1999 address to the Senate Banking Committee

www.truthaboutcredit.org

This brochure was made possible in part through grants from the Consumer Federation of America Foundation, Consumers Union, the Washington State Attorney General's Office, and the Consumer Protection Education Fund established pursuant to the settlement of a fifty state enforcement action against Sears, Roebuck and Co.

U.S. PIRG

7 February 2002

The Honorable Spencer Bachus
Chairman, Subcommittee on Financial Institutions and Consumer Credit
U.S. House of Representatives
Washington, DC 20515

**RE: Additional Question for the Record, Hearing of 1 Nov 01
Hearing On Abusive Credit Card Practices**

Dear Chairman Bachus,

Thank you for allowing U.S. PIRG to testify at the committee's hearing last November on the important issue of abusive credit card practices. I apologize for the belated reply to your request for additional information. You have asked how I reconcile U.S. PIRG's concerns that abuses in the industry are widespread with a statistic from the Federal Reserve's most recent consumer survey that "over 90 per cent of those surveyed with bank-type cards were generally satisfied in their dealings with their own credit card companies"?

In summary, this statistic is merely the answer to one poll question; in fact, its purported level of high consumer satisfaction is at odds with numerous other findings from the very survey it is extracted from. Second, much additional contrary evidence strongly suggesting that abusive credit card practices are the norm not the exception is in the form of consumer complaints, lawsuits, and, most importantly, enforcement actions by state and federal regulators, which must be given greater weight than poll samples. Third, just this week, a high-ranking government official called for warnings on credit cards, similar to those on alcohol and tobacco products.

(1) This statistic is merely the answer to one poll question; in fact, its purported level of high consumer satisfaction is at odds with numerous other findings from the very survey it is extracted from.

Although I have not examined the underlying Survey of Consumer Finances on which the Fed's poll results are based, I have carefully reviewed the Federal Reserve Bulletin article ("Credit Cards: Use and Consumer Attitudes, 1970-2000", Federal Reserve Bulletin, September 2000, pages 623-34, by Thomas A. Durkin), which analyzes the data. The SCF included questions concerning credit card usage in 1970, 1977, and 2000. The survey's general finding over time is that "unfavorable views among cardholders have increased over the decades; negative attitudes among cardholders are much more common in 2000 (42%) than they were in 1977 (14%)." (p. 627). Further, the report finds that credit users of credit cards are more negative than convenience users and those with three or more cards, high balances, hardly ever pay their full balance or have received a collection call have more negative views of the credit card industry.

**U.S. Public Interest Research Group, 218 D St SE, Washington, DC 20003
Phone 202-546-9707 Fax 202-546-2461**

(p. 628). Fully 80% of all holders of bank-type credit cards believe interest rates charged are too high.

So, while the Fed's survey may find that 90% of consumers are satisfied with their own card, it also finds that people are generally dissatisfied with credit card practices and that the level of dissatisfaction has increased over time. Without any attempt to reconcile these disparate results on a statistical basis, the Fed attempts to claim that problems with credit cards "are not nearly as widespread as consumers imagine them to be." (p. 630)

We find the reasoning specious at best, especially after reviewing the Fed's tortured attempt to belittle the significance of a finding regarding a disclosure long-sought sought by consumer groups: "Many holders of bank-type cards in 2000 said that it would be helpful to include on their billing statement information about the length of time it would take to pay off the balance if only the minimum payment were made each month." The Fed's response? "Survey respondents probably did not consider the implications and complexity of the calculations." Further, the Fed belittles another important finding that "Many respondents also reported that 'teaser rates' are confusing," with its profound analysis that "They could, of course, avoid teaser rates altogether by ignoring the mailings that promote them." (p. 629)

Our view then, is that, at best, the Fed's finding cited in your question, Mr. Chairman, is one isolated statistic that is not even the key finding of the study it is extracted from.

(2) Second, much additional contrary evidence strongly suggesting that abusive credit card practices are the norm not the exception is in the form of consumer complaints, lawsuits, and, most importantly, enforcement actions by state and federal regulators, which must be given greater weight than poll samples.

Please refer to my testimony at the hearing of 1 Nov 01 for additional details. In that testimony, I referred to civil penalties imposed against Providian, Direct Merchants and U.S. Bank for abusive credit card practices. These civil penalties were imposed following investigations by federal and state regulators. We believe that these penalties, as well as numerous recent civil lawsuit settlements made by large credit card companies, are the result of card companies' increased reliance on fee income and deceptive ways of collecting that income. The enforcement and restitution orders are available for the committee to review, as are the original plaintiff's complaints in the settlements that have been widely reported in the media. In addition, I encourage you to obtain copies of some of the thousands of individual complaints sent to the regulators. I would then encourage you to hold additional hearings at which you invite some of those victimized consumers to tell their stories.

I also refer you to the colloquy between you and me and Rep. LaFalce at the end of the question-and-answers during the hearing, where you indicated that the Comptroller, Mr. Hawke, had been invited to testify, but had declined due to "ongoing litigation." (Unedited hearing transcript, 1 Nov 01, p. 133-135). I would respectfully suggest that the presence of ongoing investigations and potential additional litigation by the nation's chief national bank regulator is significant evidence that abusive credit card practices are still a large problem.

(3) Just this week, a high-ranking government official called for warnings on credit cards, similar to those on alcohol and tobacco products.

> "A senior Treasury Department official on Tuesday urged credit card companies to devote "significant resources" to a public service campaign to promote financial literacy that would be similar in scale to alcohol and tobacco industry ads about the dangers of their products. Meanwhile, some Democrats on Capitol Hill said legislation may be needed, too, to protect consumers.
>
> "I am very concerned about the overuse of credit cards among college students," the Treasury official told reporters in a background briefing on the condition of anonymity. "To encourage responsible use of their product, it would really behoove major credit card companies ... to seriously look at funding a major media campaign."
>
> The government "can't do it all ourselves," the official said. "The private sector bears some responsibility on this."
> -- American Banker, 6 February 2002.

When the situation is so dire that an Administration official calls for a tobacco/alcohol style warning campaign by the credit card industry about the "dangers" of its product, it is clear to me that the evidence of abusive credit card practices outweighs the isolated finding in the answer to one survey question by the Federal Reserve that everything is ok.

Everything is not ok. We urge the Congress to take action to protect consumers from unfair, deceptive and abusive credit practices.

We believe the committee should move to immediate markup of Ranking Democrat John LaFalce's comprehensive package of credit reforms. We would be happy to assist the committee in its further deliberations on this matter.

Thank you again for the opportunity to testify. Again, for our detailed views, please our testimony of 1 November 2001 and our report "The Credit Card Trap" and accompanying fact sheet released in April 2001, <http://www.truthaboutcredit.org>. Please have your staff contact me if you have additional questions.

Very truly yours,

Edmund Mierzwinski (via email)

Edmund Mierzwinski
Consumer Program Director

Cc: The Honorable John LaFalce, Ranking Member

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WRITTEN STATEMENT OF JOSHUA L. PEIREZ
SENIOR LEGISLATIVE AND REGULATORY COUNSEL
MASTERCARD INTERNATIONAL INCORPORATED

HEARING BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
OF THE
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

NOVEMBER 1, 2001

Chairman Bachus, Congresswoman Waters, and members of the Subcommittee, my name is Joshua Peirez. I am the Senior Legislative and Regulatory Counsel for MasterCard International Incorporated ("MasterCard"). MasterCard is a global membership organization comprised of over 22,000 financial institutions that are licensed to use the MasterCard service marks in connection with a variety of payments systems. MasterCard and its members have always provided, and are fully committed to providing, extensive consumer benefits and the highest quality of consumer services. I thank the Subcommittee for taking the time to consider these issues and for the opportunity to discuss how MasterCard and its members serve and benefit MasterCard cardholders.

Benefits of MasterCard

MasterCard payment cards are enormously beneficial methods of payment for consumers and merchants alike. An individual carrying a MasterCard payment card knows that he or she can walk into an establishment almost *anywhere in the world* and make a purchase using his or her MasterCard card. In fact, MasterCard cardholders can transact in more than 150 currencies without the need to exchange large amounts of cash. A MasterCard cardholder can virtually travel the world with only a single piece of plastic about 3½" by 2" large and make payments without the need to carry large amounts of cash or travelers checks. A MasterCard cardholder can also buy everything from groceries to doctors' services on a MasterCard card. Our popular advertising campaign says it best: "there are some things money can't buy…for everything else, there's MasterCard." In essence, the MasterCard system is an integral part of the globalization that has fueled our economy over the last thirty years.

MasterCard cardholders can use a MasterCard payment card at millions of merchants. That means fewer trips to the bank, or ATM, and no longer having to worry about carrying the right amount of cash, losing it, or having it stolen. MasterCard cardholders also receive a convenient, detailed accounting of their spending through periodic statements provided by their card issuers. Many times, cardholders obtain what is essentially an interest-free loan for some period of time.

Further, a MasterCard cardholder need not even leave the comfort of his or her own home to shop the globe. The Internet has become a powerful tool for consumers to shop for the lowest prices on a myriad of products. This rapid development of e-commerce is due in large part to a cardholder's ability to pay for a product on-line by using a payment card. It is no overstatement to claim that the Internet would not be such a critical part of our economy today if it were not for the widespread use and acceptance of payment cards. Furthermore, MasterCard is developing, and intends to continue to develop, new and innovative payment options and features related to Internet purchases.

It is also important to note that MasterCard payment cards are valued not just by consumers. Approximately 22 million merchants worldwide have decided to accept MasterCard payment cards to improve business. The guarantee of payment from the MasterCard system is the cornerstone of the MasterCard merchant proposition. A merchant accepting a MasterCard payment card knows that he or she will be paid for goods or services. The merchant typically does not have that protection in accepting a check since the check may bounce. Indeed, the majority of merchants do not even accept checks from outside their local area.

In addition, acceptance of MasterCard cards can be more convenient, cheaper, and safer than other available forms of payment. As an example, merchants need not worry about cash being stolen (by employees or outsiders) and need not worry about physically depositing funds or checks as MasterCard cards allow merchants to deposit funds into their accounts electronically. Naturally, the acceptance of MasterCard payment cards (along with other payment forms) also allows merchants to give their customers a variety of payment options, which enhances overall customer satisfaction and, importantly, increases sales. It is the increased sales, decreased costs, and enhanced customer satisfaction that has led so many businesses to choose to accept MasterCard cards.

MasterCard has also created a great deal of choice through the vigorous competition with other payments systems and forms of payment as well as among the thousands of MasterCard member financial institutions. Indeed, through the innovation of MasterCard and its members, consumers have thousands of card programs from which to choose. For example, MasterCard cards can be credit cards, debit cards, secured cards, cobranded or affinity cards, or prepaid cards, among many others. This allows consumers to choose great rewards programs, to donate portions of proceeds to favorite charities, and to enjoy attractive interest rates, among many other options.

With all these card programs, the consumers receive the tremendous benefit of universal acceptance, *i.e.*, the knowledge that their cards will be accepted at any of the merchants that accept MasterCard worldwide, regardless of which MasterCard member issued the card, and regardless of the underlying terms of such issuance. Whether the card is a credit card, a prepaid card, a debit card, a platinum card or a secured card, whether the card has a $20,000 or a $200 credit line, whether the card offers frequent flier miles or not, the consumer knows that it will be accepted. This, in and of itself, illustrates the fabulous proposition that is MasterCard, but there is much more that MasterCard has done to increase the security and therefore the consumer benefits of MasterCard cards, as described below.

Consumer Protections

MasterCard is also pleased to offer its cardholders outstanding consumer protection benefits. In fact, we believe that our cardholder protections are extremely valuable as they provide consumers with the security and comfort necessary to make the MasterCard system "the best way to pay for everything that matters." For example, MasterCard has voluntarily implemented a "zero liability" policy for the unauthorized use of MasterCard consumer cards issued in the United States. It is important to note that MasterCard's policy with respect to zero liability is superior to what is required by law. Specifically, the Truth In Lending Act imposes a $50 liability limit for the unauthorized use of credit cards. Under the Electronic Fund Transfer Act, a cardholder's liability for unauthorized use of a debit card can be higher. However, MasterCard provides all U.S. MasterCard consumer cardholders, regardless of the particular card type, with even more protection. Under MasterCard rules, a cardholder victimized by unauthorized use generally will not be liable for any losses at all. This has greatly enhanced consumer confidence, including with respect to shopping on-line. Although many Internet merchants have taken care to provide consumers with a secure transaction environment, MasterCard cardholders can shop on-line with the confidence that they will have no liability in the unlikely event that their account number is misused.

Cardholders who use MasterCard cards also gain additional protections against merchants who do not perform as expected. In many instances, if a cardholder uses his or her MasterCard card to pay for a product or service, and the merchant does not provide the product or service as promised, the issuer can "chargeback" the transaction and thereby afford its cardholder a refund. This is a valuable consumer protection that is obviously not available with other forms of payment such as cash, checks, or travelers checks.

Customer Satisfaction

Consumer feedback also demonstrates the high quality of the services the payments industry provides to consumers. MasterCard is pleased to note that a recent survey by Thomas A. Durkin, of the Federal Reserve Board's Division of Research and Statistics, published in the Federal Reserve Bulletin indicates that consumers are extremely satisfied with their payment cards. For example, 91% of consumers who have a bank-issued payment card are "generally satisfied in [their] dealings with [their] card companies" and 92% believe "card companies provide a useful service to consumers." The survey also found that 90% of bankcard holders agree with the statement that "my credit card companies treat me fairly." Durkin also noted that, to the extent the survey revealed some negative opinions with respect to payment cards, any "negativity may have arisen in part from an individual's perceptions of *other* consumers' difficulties rather than from the individual's own experiences…it seems likely that as card use has become more common, negative opinions about card use may [be] a result of perceptions about 'the other guy.' Views about personal experiences with [] cards, in contrast, are much more positive." (emphasis in original)

How many other major industries can claim a customer satisfaction rate of 90%?

Financial Education

MasterCard firmly believes that financial literacy is critical for individuals of all ages. With this in mind, MasterCard has developed numerous important consumer financial education programs and continues to work with Congress and the Administration on additional efforts to improve consumer financial awareness. The following are just some of MasterCard's consumer education programs:

- **"Are You Credit Wise?"** With the support of national student leaders, MasterCard developed a campus-based education program providing money management information to college students.

- **Creditalk.com**. Creditalk.com is an interactive financial education web site created and operated by MasterCard. The site offers a variety of money management information for new and experienced credit consumers such as: obtaining and understanding a credit report; establishing and managing a budget; dealing with a debt crisis; and calculating when outstanding balances will be paid off using an on-line credit calculator. And because web-based initiatives must stay current and fresh, MasterCard is now investing in redesigning and relaunching this site so that it is even more helpful for consumers.

- **"Kids, Cash, Plastic, and You."** This is a highly successful consumer education magazine developed with the former U.S. Office of Consumer Affairs. The magazine provides tips to help parents teach children about money management and outlines a "parent coach" approach for achieving this goal.

- **League of United Latin American Citizens (LULAC).** Through its partnership with LULAC, MasterCard has developed "The Art of Building a Financial Future" that is helping Latino leaders conduct financial management workshops in communities across the United States.

- **"Master Your Future."** The "Master Your Future" program materials consist of a video and curriculum guide for high school teachers that can be integrated into their lesson plans. More than 23 million students have had the opportunity to develop positive personal finance habits as necessary life skills through this program.

- **"Money Talks."** A collaboration between MasterCard and College Parents of America, the Money Talks brochure provides advice to parents on how to talk to their college-aged students about personal finances.

MasterCard is also active in Washington with respect to efforts to improve our nation's financial literacy. For example, MasterCard is a strong supporter of H.R. 61, the "Youth Financial Education Act" introduced by Representatives David Dreier and Earl Pomeroy. The Dreier-Pomeroy legislation would authorize the Secretary of Education to provide grants to state educational agencies to develop and integrate youth financial education programs for students in elementary and secondary schools. We are pleased that the House and Senate have each incorporated this bill in the larger education reform measure that currently awaits final action in conference.

MasterCard has also been working with the current Administration to develop approaches to increasing financial literacy. We were pleased to see that Secretary O'Neill had been scheduled to testify in the Senate to highlight the Administration's efforts in this area. Unfortunately, the hearing had been scheduled for shortly after the terrorist attacks and has not yet been rescheduled. MasterCard looks forward to resuming our progress on this matter at the appropriate time.

Conclusion

MasterCard is proud of its, and its members', record of offering cardholders and merchants a highly beneficial and convenient payment method with superior protections. MasterCard is also proud of its efforts in the private and public sectors to improve financial literacy for Americans of all ages. Quite simply, we have set high standards, and, as always, we will strive to meet them.

Mr. Chairman, thank you again for the opportunity to discuss MasterCard's commitment to its cardholders. I would be pleased to address any questions the Subcommittee may have.

WRITTEN STATEMENT

OF

L. RICHARD FISCHER

ON BEHALF OF

VISA U.S.A. INC.

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND

CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

November 1, 2001

Chairman Bachus, Ranking Member Waters, and Members of the Subcommittee, my name is Rick Fischer. I am a partner of Morrison & Foerster and I practice in the firm's Washington, D.C. office. I am appearing today on behalf of Visa U.S.A. Inc. Thank you for the invitation to participate in this hearing on the credit card industry.

The Visa payments system is a membership organization comprised of 21,000 financial institutions licensed to use the Visa servicemarks. It is the largest consumer payment system in the world. Over 800 million Visa-branded cards are accepted at over 20 million locations. Consumers use them to buy over $1.8 trillion in goods and services annually on a worldwide basis. Visa U.S.A., which is part of the Visa payment system, is comprised of 14,000 U.S. financial institutions. U.S. customers carry about 350 million Visa-branded cards and use them to buy over $900 billion worth of goods and services annually.

Over the last 30 years, U.S. consumers have embraced general purpose credit cards and similar payment products. In 1970, 16 percent of U.S. families had bank-type credit cards; by 1998, that number had increased to 68 percent.[1] This dramatic increase is not surprising considering the convenience and benefits that credit cards and similar payment products offer consumers. Credit cards are used by consumers both for making payments and as a source of revolving credit. Credit cards, debit cards and similar payment products act as substitutes for cash and checks and make many transactions possible that otherwise would be less convenient. Credit cards also serve as a flexible substitute for other personal loans and installment sales contracts.

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[1] Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes*, 1970-2000, 86 Federal Reserve Bulletin 623, 625 (2000).

The business of providing credit cards and similar payment products is highly competitive. Card issuers have developed thousands of competing card products with a wide variety of features, as they seek to satisfy increasingly specialized consumer interests. And the continuing efforts of Visa members and other issuers to attract and service customers have benefited consumers by providing them with a convenient and flexible tool to engage in retail transactions. Indeed, credit cards have become an increasingly important facilitator of consumer demand for products and services that, in turn, helps to fuel much of our economy today.

Importantly, the Visa system puts the choice of how to pay in the hands of the consumer. In our view, the decision for how to spend money should rest with the person who has the money, whether the CONSUMER chooses to pay with his or her credit or debit card, cash or check.

Under the Visa system, each member bank establishes its own fees, finance charges, credit limits, credit standards and rewards programs (such as airline miles or in-store benefits) for the cards it issues. Each bank also determines how many cards it wants to issue, as well as the focus of its marketing efforts. In addition, each Visa member prepares its own disclosures, develops its own privacy notices, handles its own consumer complaints and absorbs losses on its own accounts, and much of these activities are closely regulated by existing federal laws. For example, the federal Truth in Lending Act establishes rules for the solicitation disclosures, initial disclosures, monthly statement disclosures and change in terms disclosures that all credit card issuers in the U.S. must follow. The federal Electronic Fund Transfer Act establishes similar rules for debit cards. And the recently enacted Gramm-Leach-Bliley Act establishes extensive rules under which all financial institutions, including all credit card and debit card issuers, must follow in disclosing their privacy or information practices to their customers. In fact, there are few activities of credit card issuers that are not already heavily regulated by federal statute, and federal agencies like those that appeared before you earlier in this hearing.

In addition, card issuers realize fully that their businesses depend on customer satisfaction. As a result, Visa members and other card issuers compete with each other on every aspect of the account relationship -- including fees, finance charges, credit limits, credit standards, reward programs and customer service. To the extent that an issuer fails to meet consumer expectations, the relative ease with which consumers can move balances between credit card accounts allows consumers effectively to vote with their feet when they are not satisfied. This highly competitive market ensures that consumers have choice in payment card products. In fact, many secondary sources have developed to help consumers compare and evaluate credit card products quickly and easily -- term-by-term and feature-by-feature.

Visa has long recognized that consumers will be best served if they have a solid understanding of personal financial management. Visa also believes that it is important for financial institutions to anticipate the needs of their customers and to be responsive to changing circumstances.

I would like now to focus on three examples to illustrate these points. The first relates to steps that Visa and its members have taken to provide financial education to cardholders, as well as to elementary, secondary and college students. The second is the protections that Visa and its members are providing to cardholders through their "zero liability" policy for unauthorized use of Visa payment cards and Visa's extensive fraud control efforts. The third is the spontaneous steps that Visa members and others in the credit card industry have taken to help cardholders in the aftermath of the terrible terrorist attacks that took place on September 11, 2001.

FINANCIAL EDUCATION

In a recent speech to the National Council on Economic Education, Federal Reserve Board Chairman Alan Greenspan stated:

> Improving basic financial education at the elementary and secondary school level can provide a foundation for financial literacy, helping younger people avoid poor financial decisions that can take years to overcome.[2]

This statement comes as no surprise to Visa and its members, since they have long recognized the importance of financial education. In fact, Visa and its members have undertaken multiple programs in their commitment to promoting financial literacy for children and young adults. Visa's comprehensive financial literacy initiative -- called Practical Money Skills for Life -- is a free online educational resource for parents, teachers, students and consumers. Visa and its members have developed this holistic approach because they believe a smart consumer is the best consumer, armed with the tools they will need to make educated choices about their finances throughout their lives.

Classroom Resources

- ***Practical Money Skills for Life: Internet-Based Curriculum*** – Visa provides a free online K through 12 Practical Money Skills curriculum to

[2] Chairman Alan Greenspan, The Importance of Financial Education and Literacy, Remarks before the National Council on Economic Education 3 (Oct. 26, 2001).

more than 200,000 educators and 5 million students nationwide. From making a budget and sticking to it, to buying a first home, Practical Money Skills for Life helps ensure students are fiscally fit. Visa also has provided computer labs and educator professional development to many schools and school districts across the U.S.

- ***What's Up with Money in Your Life*** – Visa recognizes that college-bound freshmen, who will be managing money for the first time away from home, can use a little help learning the financial ropes. So Visa has created a turn-key educators' kit for freshman orientation directors at colleges to develop and incorporate a personal finance quick study in freshman orientation. The kit has been distributed annually since 1998 and has been sent to college campuses throughout the U.S.
- ***LifeSmarts*** – Visa is a proud sponsor of LifeSmarts, a program of the National Consumers League. Practical Money Skills is the official teaching curriculum for educators participating in LifeSmarts. LifeSmarts is a state and national competition for teens that helps them develop their consumer and marketplace knowledge in an enjoyable game format.

Parent Resources

- ***Parent Resource Center on www.PracticalMoneySkills.com*** – In a fast-paced financial world, parents can use a little help in teaching their children to be financially savvy. To support the unique needs of parents, Visa has joined forces with Jayne Pearl, author of *Kids and Money: Giving Them the*

Savvy to Succeed Financially, to offer easy to implement parenting strategies for raising a fiscally fit generation. Parents with children of any age will find useful tips for teaching how to make a budget and stick to it, how to avoid spending pitfalls and important lessons about saving and investing.

- ***Practical Money Skills for Life CD-ROM*** – For families with computer access, Visa has developed a CD-ROM that teaches important financial lessons through interactive games and quizzes. Most appropriate for young adults (16-22), the Practical Money Skills CD-ROM can be played by individuals or small groups. One component of the CD-ROM called Money Management Intelligence will lead the player through a real life simulation of a character's financial choices, putting him or her in the driver's seat to make the money decisions that will affect the character's financial well-being.

Military Family Resources

Most recently, Visa has partnered with the Reserve Officers Association in an effort to help provide financial information and resources to members of the military community deployed as a result of Operation Enduring Freedom. Through this partnership, Visa and the Reserve Officers Association are distributing information packets related to money management based on content from Visa's free, online, financial literacy resource, Practical Money Skills for Life. The information packets are distributed in affiliation with the Reserve Officers Association Defense Education Forum.

Other Educational Resources

Visa and its members also have undertaken steps to educate consumers regarding financial management skills. These programs include:

- ***Knowledge PayS*** – A consumer magazine that helps consumers understand today's payment products and learn important money management strategies related to budgeting and saving, as well as tips for shopping on the Internet and protecting against fraud.
- ***Managing Your Debts*** – A consumer-friendly brochure that helps consumers facing potential financial difficulty to regain their fiscal fitness. Produced in conjunction with Consumer Federation of America, Managing Your Debts highlights the warning signs for financial difficulties by presenting real-life scenarios and solutions.
- ***Creditpage.com*** –Visa also is a sponsor of Creditpage.com, the place to learn how to manage and protect your credit. An individual may use the Web site to test his or her financial situation, to order and better understand his or her credit report and to find out more about credit counseling agencies that can help individuals regain financial vitality.

CONSUMER PROTECTIONS THROUGH ZERO LIABILITY AND FRAUD CONTROL

Zero Liability

Under federal regulations, credit card issuers are required to limit liability for unauthorized use of credit cards to $50. The corresponding liability limit for debit cards may be higher. However, Visa and its members have chosen to go beyond these requirements to ensure that cardholders are fully protected against monetary losses due to fraudulent use of their payment cards.

Recognizing that technological and market developments could lead to an increased concern on the part of consumers about the integrity of their transactions, Visa implemented a new operating regulation in April of 2000 that eliminates consumer liability in cases of unauthorized use of Visa payment cards. This zero liability policy covers the use of all Visa consumer card products -- including both debit and credit cards. As a result of this new policy, a consumer will not be held liable for unauthorized use of any Visa consumer payment card.

This zero liability policy applies to online transactions as well as offline transactions. Customers are protected online in exactly the same way as when they are using their cards at a store, ordering from a catalog by mail or placing an order over the telephone. In case of a problem, Visa provides unprecedented protection against unauthorized card use, theft or loss. If someone steals a Visa payment card or a Visa card number from one of the Visa cardholders while the cardholder is shopping, online or offline, the cardholder is fully protected -- they pay nothing for the thief's fraudulent activity.

Fraud Control Programs

In addition, Visa has been a leader in combating fraud -- including identity theft -- for more than a decade. It is in the common interest of Visa, its members, consumers and merchants to prevent fraud. Fraud prevention protects merchants from absorbing the costs of fraud and protects consumers from the higher prices that they would have to pay in order to cover fraud losses. Fraud prevention further protects consumers from the trouble of having to identify and reverse unauthorized transactions. For these and other reasons, preventing fraud involving Visa credit and debit cards is a top priority for Visa and its members. Fraud prevention also is essential in protecting the integrity of the Visa brand and maintaining the confidence of consumers and merchants that use the Visa payment system. Through significant investments in technology, cooperative efforts between Visa, its members, and law enforcement agencies and a wide variety of educational initiatives, the incidence of Visa-system fraud in recent years is at an all-time low, even as the volume of Visa card transactions has grown dramatically.

Visa and its members have developed a varied arsenal of fraud control programs that helps merchants reduce the incidence of unauthorized use of Visa payment cards. These programs include:

Application Verification

- The Application Verification system verifies an applicant's address, telephone and Social Security number and whether the address, telephone and/or Social Security number utilized on submitted applications have previously appeared on fraudulent applications or in prior credit card fraud transactions.

Card Activation Method

- A Card Activation Method is used by most Visa card issuers to confirm that a card has been received by the cardholder before activating the account. Under this method, cards are blocked from use at the time of mailing. For the card to be activated, the cardholder typically must call the issuer, often from the same phone number previously provided to the issuer by the cardholder, and must confirm receipt and provide proof of identity.

Address Verification Service

- The Address Verification Service is a fraud prevention system that allows merchants to verify automatically that a shipping address provided by a cardholder at the time of purchase matches the cardholder's billing address and other information. This service helps merchants minimize the risk that they will accept fraudulent orders from persons using stolen cardholder information.

Cardholder Risk Identification Service

- Visa's Cardholder Risk Identification Service ("CRIS") is a transaction scoring and reporting service that employs advanced neural network technologies to develop artificial intelligence risk-scoring models that help identify fraudulent transaction patterns. Card issuers can use CRIS as a stand-alone fraud detection system, or together with their own internal fraud detection methods.

Exception File

- Visa's Exception File is a worldwide database of account numbers of lost/stolen cards or other cards that issuers have designated for confiscation, referral to issuers or other special handling. All transactions routed to Visa's processing system have their account numbers checked against this Exception File.

Card Verification Value

- The Card Verification Value ("CVV") is not printed on the card itself, but can be found on the card's signature strip on the back of the card. These codes help merchants confirm that cardholders are in possession of the actual card. Online merchants and other merchants in situations where the card is not present at the merchant's premises during the transaction can verify that their customers have the actual card in their possession by requesting the customer to provide the CVV from the signature strip.

Payer Authentication Service

- Visa's Payer Authentication Service is currently in the implementation phase. This service will enable issuers to confirm a cardholder's identity to an Internet merchant during the virtual (online) checkout process. This process will be accomplished using a password that the cardholder registers with his or her card issuer. The process will help reduce fraud by enabling

Internet merchants to confirm the cardholder's identity at the time of purchase.

Data Security Requirements

- Visa was the first card company in the industry to develop and publish data security requirements for all entities holding card data (such as merchants, gateways, internet service providers, etc.). This program includes education for merchants, merchant self-evaluations and logical firewall testing (the latter is in the pilot stage now). With these requirements in place, the theft of information that can facilitate identity theft is reduced.

Materials to Issuers on Identity Theft Fraud

- Visa has helped to develop a video and other materials on identity theft that are designed to help card issuers combat fraud related to identity theft.

These extensive fraud detection and prevention programs have achieved significant success. For instance, in 1992, the ratio of fraud-to-sales on Visa cards was just .15 percent or 15 cents out of every $100. That has now dropped to just .08 percent, or 8 cents out of every $100, as of last year. Indeed, during recent years the absolute number of fraudulent transactions in the Visa system has actually been reduced, even as Visa card volume has soared. We are extremely proud of the success of our many fraud prevention efforts.

RESPONSE TO SEPTEMBER 11 ATTACKS

Visa members and others in the banking industry have worked closely with federal authorities in the aftermath of the September 11 attacks. In addition, Visa members have been proactive in assisting customers that have been either directly or indirectly affected by the September 11 attacks. For example, many banks have waived late fees and interest charges on customer accounts. One bank temporarily suspended enforcement of due dates completely soon after the September 11 attacks to help its customers. Another bank estimated that it has waived more than $15 million in fees and interest in the past month alone. Still another bank searched through its records to identify whether victims of the September 11 attacks held its credit cards. For victims identified, the bank chose simply to forgive the debts, even though it was not required to do so by law, because the bank wanted to do its part. Banks also are reviewing their mail operating procedures in light of the anthrax and mail scares to ensure that they can address delays in the mail, and to be sure that their own mail operations are as safe and secure as possible. In addition, banks are working to comply as quickly as they can with the Soldiers' and Sailors' Civil Relief Act of 1940, which protects persons called to active military service and their dependents from undue hardship resulting from their military service. Overall, I have found that banks are not asking what they must do to comply with the law; instead, they are asking how they can help -- how they can do their part to respond to the September 11 attacks.

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Visa appreciates the opportunity to appear before you today. I will be happy to answer any questions that you may have.

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